Financial History

The magazine of the Museum of American Finance

The Promise and Peril of Capitalism

Annual Shareholder Meetings: From Populist to Virtual

Albert Gallatin and a Nation Free From Debt

ISSUE 127 | FALL 2018

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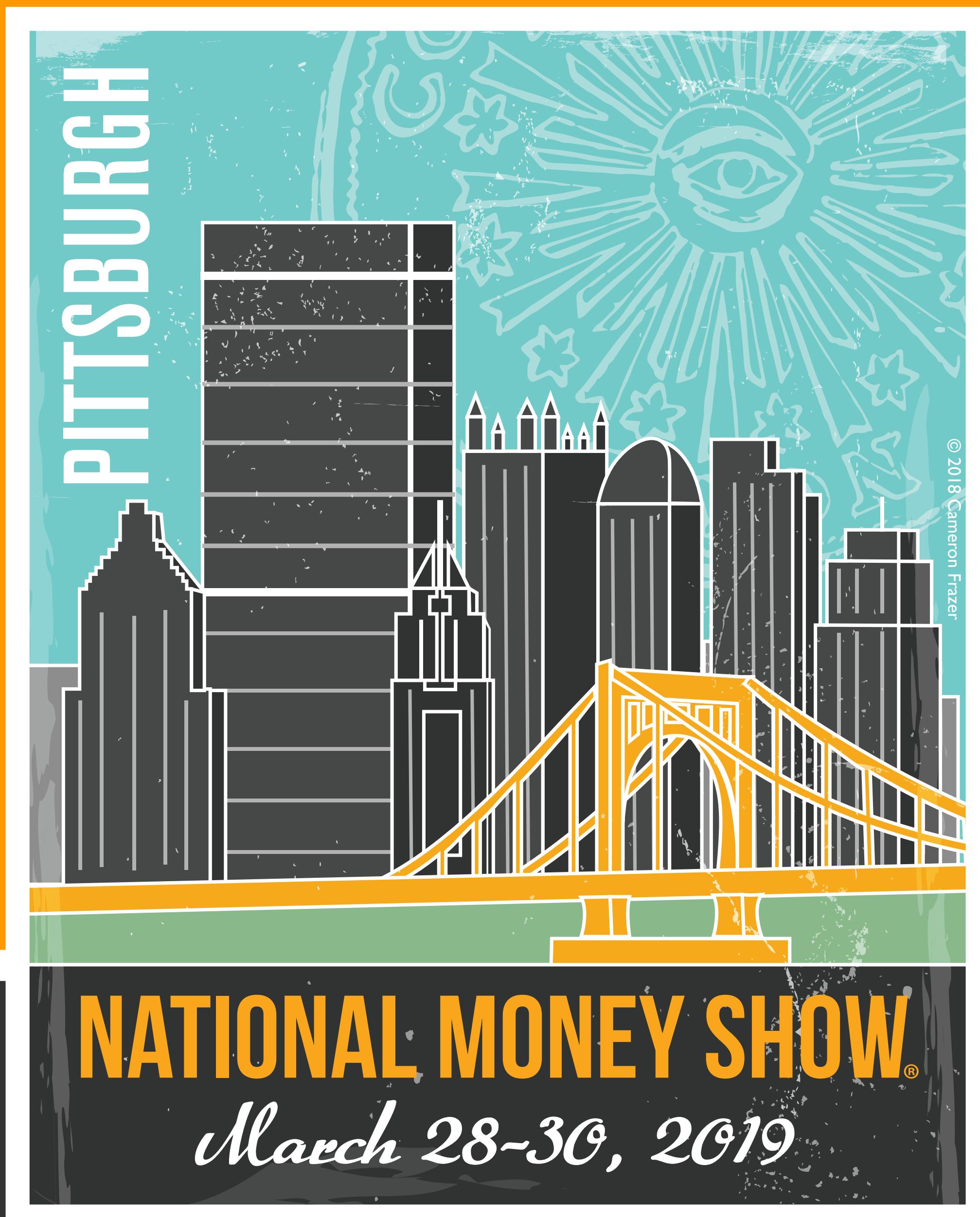

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THE MAGAZINE OF THE
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IN THIS ISSUE FEATURES


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Courtesy of Lambton County Archives

IN THIS ISSUE DEPARTMENTS

ON THE COVER

Photographs from Dollar Street, which features portraits of families in 300+ homes in 52 countries and orders them by monthly income. Shown here are (clockwise from upper left): Ukraine ($10,090), Jordan ($7,433), China ($730) and Haiti ($39). See related article, page 11.

Dollar Street

MoAF Announces 2019 Gala Honorees

Message to Members

David J. Cowen | President and CEO

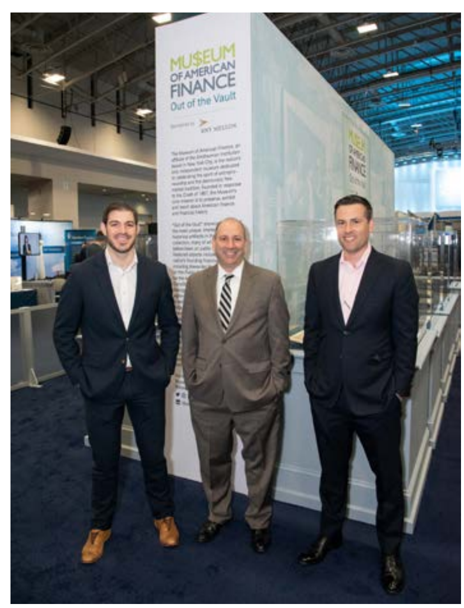
It has been a busy year of public programs at the Museum, despite our exhibit gallery remaining closed due to the flood in January. We have hosted 15 events this year—including six programs in our Evening Lecture Series—at outside venues around the city. This has enabled us to expand our audience, as our programs are now more easily accessible to those who live and work in midtown and uptown, in addition to Lower Manhattan.

We were also fortunate to be able to continue our premier education program—the Museum Finance Academy—with sessions held on Thursday and Friday afternoons at our temporary offsite location. More than 40 high school students are currently enrolled in this free eight-week personal finance course, which combines classroom instruction with interactive events and trips. The top performers will receive partial college scholarships, and we will announce their names on our website and in the next issue of *Financial History*.

We also recently expanded our exhibit outreach, as we showed more than 40 highlights from our permanent collection in our new travelling exhibit, "Out of the Vault," which we displayed at the 2018 Schwab IMPACT conference in Washington, DC, this October (*see article, page 8*). Also this fall, we were represented on an international stage at the International Federation of Finance Museums (IFFM) Annual Meeting in Brussels. MoAF Vice Chair Andrea de Cholnoky spoke about our plans for the future, as more than 20 finance museums from around the world discussed "Financial Education: Global Perspectives & Challenges."

As we look towards the future, I am excited to announce that we have secured our 2019 Gala honorees, each of whom have made important contributions to the world of finance and economics. The Whitehead Award for Distinguished Public Service and Financial Leadership will recognize the significant contributions of Dr. Janet Yellen, former chair of the Federal Reserve Board and distinguished fellow in residence at The Brookings Institution. The Charles Schwab Financial Innovation Award, which recognizes individuals who have introduced new markets or new financial instruments to our financial system, will be presented to Laurence D. Fink, chairman and CEO of BlackRock.

The 2019 Gala will be held on February 5 at Cipriani Wall Street. For information on how you or your firm can participate, please see www.moaf.org/2019gala. We hope to see many of you there. $



Top to bottom: Dr. Janet Yellen; Laurence D. Fink; David Cowen (center) with Dan Varley and Matthew Hamilton from BNY Mellon, sponsors of the Museum's "Out of the Vault" exhibit at the 2018 Schwab IMPACT conference.

Museum of American Finance and Fordham Gabelli Center Co-Present Program with Legendary Investor Howard Marks

On October 3, the Museum co-hosted its fourth event this year with the Fordham University Gabelli Center for Global Security Analysis. Howard Marks, one of the most successful Wall Street investors of all time, spoke to a sold-out audience of Museum members and Gabelli Center faculty and alumni about his new book, *Mastering the Market Cycle: Getting the Odds on Your Side*.

The program was part of the Museum's highly-acclaimed Evening Lecture Series, and it was live streamed in partnership with the CFA Society of New York. The program was presented in a conversation format, with Bloomberg Television's Erik Schatzker conducting the interview.

Howard Marks is the co-chairman and co-founder of Oaktree Capital Management, a Los Angeles-based investment firm with over $100 billion in assets under management. He provided practical insight and analysis on how to understand, track and react to the ups and downs of the stock market, including the hidden logic in carefully pinpointing market trends so that investors have the opportunity to improve their results. He also stressed the importance of carefully studying past market cycles, as well as the role that fundamental psychological influences play in investing.

The video of this program can be viewed on the CFA Society of New York's website and can also be found at www.moaf.org/howardmarks. $

Photos: Bruce Gilbert

Clockwise from top: Bloomberg's Erik Schatzker interviewed Howard Marks at the sold-out MoAF/Fordham event; Fordham Gabelli School Dean Donna Rapaccioli, MoAF Trustee Mark Shenkman, Howard Marks and MoAF President David Cowen at the October 3 event; Oaktree Capital Management Co-Chairman Howard Marks.

MoAF and Cheddar Collaborate on New C-Suite Video Series: "Disrupting Wall Street"

In October, the Museum launched a new monthly video series featuring C-Suite executives from across the financial industry discussing "Disrupting Wall Street: The Power of FinTech," a conversation on how technology is impacting their own companies and their particular industry segments. A follow-up to the recent CEO Video Series, the C-Suite Series Part 2 continues the successful collaboration between the Museum and Cheddar Media, a live and on demand news network covering technology, media and entertainment, which broadcasts daily from the floor of the New York Stock Exchange.

The first video in the series, featuring Museum President & CEO David Cowen with Cheddar Founder & CEO Jon Steinberg, debuted on October 25 on the Museum's YouTube channel, as well as on Cheddar's website and across both organizations' social media platforms.

According to MoAF President David Cowen, the impact of technology on the transformation of financial services is among the most critical topics in the industry today. "The new C-Suite Series will help us share personal insights on how technology is reshaping the financial industry and broadening access to financial services," he said.

The companies participating in this series (as of publication) are Fitch Solutions (November), Broadridge Financial Solutions (December), Protiviti (January), Citi (February), TIAA (March), CommonBond (April), New York Life (May) and Chase (June).

Cheddar CEO and Founder Jon Steinberg said, "I'm excited to continue working with the Museum of American Finance on 'Disrupting Wall Street.' Stories about innovation and disruption in finance are at the core of what we are doing at Cheddar, so we jumped on the opportunity to bring even more of this substantive content to our audience."

Each month, the featured executives, with such titles as President, Chief Technology Officer, Chief Digital Officer, Chief Information Officer and Chief Innovation Officer, will be featured on the Museum's YouTube channel. They will appear on CheddarTV, as well. $

UPCOMING EVENTS CALENDAR

Nov 14 Evening Lecture Series: "Democratizing Finance." Fireside chat featuring PayPal CEO Dan Schulman, followed by panel discussion. 6:15–8:00 p.m. Program followed by Q&A and reception. Sponsored by Protiviti and TIAA. The Paley Center for Media, 25 West 52nd Street, NYC. General admission $50; MoAF members free. Reservations required.

Nov 24 Walking Tour: George Washington's New York. 11:00 a.m.–12:30 p.m. $15 per person. Tour meets outside 48 Wall Street.

Nov 28 Evening Lecture Series: Kate Welling and Mario Gabelli on *Merger Masters: Tales of Arbitrage*. 5:45–8:00 p.m. Presented in partnership with the Fordham University Gabelli Center for Global Security Analysis and the CFA Society of New York. Talk followed by Q&A and reception. Fordham University Lincoln Center Campus, McNally Amphitheatre, 140 West 62nd Street, NYC. First 250 attendees will receive a copy of the book. General admission $25; MoAF members free. Reservations required.

Dec 6 Walking Tour: Founding Financiers. 11:00 a.m.–12:30 p.m. $15 per person includes admission to the Lunch and Learn with Gregory May. Tour meets outside 48 Wall Street.

Dec 6 Lunch and Learn Series: Gregory May on *Jefferson's Treasure: How Albert Gallatin Saved the New Nation from Debt*. Talk followed by Q&A and book signing. 12:30–1:30 p.m. General admission $5; MoAF members and students free. 48 Wall Street, 5th Floor.

Dec 29 Walking Tour: Holidays on Wall Street. 11:00 a.m.–12:30 p.m. $15 per person. Tour meets outside 48 Wall Street.

Feb 5 2019 MoAF Gala Honoring Dr. Janet Yellen and Laurence D. Fink. 6:30–9:30 p.m. Cipriani, 55 Wall Street, NYC. Information can be found at www.moaf.org/2019gala.

For more information or to register online, visit www.moaf.org/events.

"Democratizing Finance" Program Will Feature Fireside Chat with PayPal President Dan Schulman

On November 14, the Museum will present "Democratizing Finance: Expanding Access through FinTech," a timely program on the transformation in the financial services industry—connecting people to affordable financial services anywhere and at any time—that is expected to generate economic growth and help reduce income inequality. The program will be held from 6:00—8:30 pm at The Paley Center for Media.

The evening will begin with a fireside chat featuring PayPal President & CEO Dan Schulman and program moderator Brian Sozzi, Editor-at-Large of Yahoo! Finance. It will include a conversation on the impact of the revolution in financial services brought by the digitization of money and the proliferation of Internet access and mobile phones.

A panel discussion will follow addressing the broad implications of financial technology on consumers and society at large. Panelists include Andrew Keys, Co-Founder, ConsenSys Capital; Aditya Khurjekar, Founder & CEO, MEDICI; and Jennifer Tescher, President & CEO, Center for Financial Services Innovation.

"Democratizing Finance" is co-sponsored by Protiviti and TIAA, with media sponsor Thisis212. It is presented by the Museum of American Finance, in partnership with the Fordham University Gabelli Center for Global Security Analysis.

More information on this program can be found at www.moaf.org/democratizingfinance. Join the conversation at #DemocratizingFinance. $

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Museum Displays "Out of the Vault" Exhibit at Schwab IMPACT 2018 Conference in Washington, DC

By Sarah Poole, Collections Manager

The Museum displayed "Out of the Vault," a traveling exhibition of more than 40 highlights from its permanent collection, at the Schwab IMPACT 2018 Conference, which was held at the Walter E. Washington Convention Center, in Washington, DC, from October 28-31. "Out of the Vault" showcased some of the most unique, interesting and historical artifacts in the Museum's collection, many of which have never before been on public display.

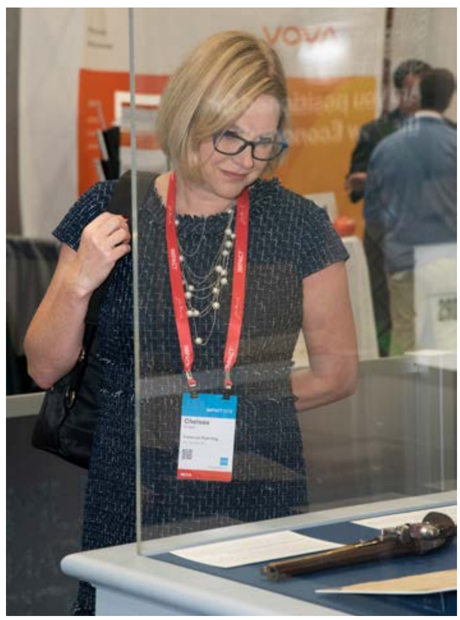
Featured objects included some of the nation's founding financial documents, such as Alexander Hamilton's *Report on the Public Credit*—considered to be the economic equivalent of the US Constitution—as well as the 1792 George Washington bond, which was signed by President Washington and is believed to bear the first use of the dollar sign on a US federal document. Many artifacts were signed by American political and business leaders from the 18th century through today, while others highlighted technological innovations that transformed the financial services industry. Together, these objects represented more than 225 years of American financial history and achievement.

IMPACT is an annual conference for independent registered investment advisors and independent record keeper clients of Charles Schwab & Co., Inc. It is considered the premier benchmark event for the RIA industry, with world-class keynote speakers, education sessions, networking opportunities and industry exhibits. "Out of the Vault" was on display in the "The Exchange," a central exhibit hall for attendees to connect, learn and refresh during the conference.

Museum President David Cowen offered tours of the exhibit, giving visitors greater insight into the significance of the artifacts on display and helping to connect financial history to present-day finance. David also had the opportunity to give a private tour to Janet Yellen, former Chair of the Board of Governors of the Federal Reserve, who gave a keynote address at IMPACT. Dr. Yellen will receive the Whitehead Award for Distinguished Public Service and Financial Leadership at the Museum's 2019 Gala.

This traveling exhibit was sponsored by BNY Mellon. $

Photos: Norwood Photography

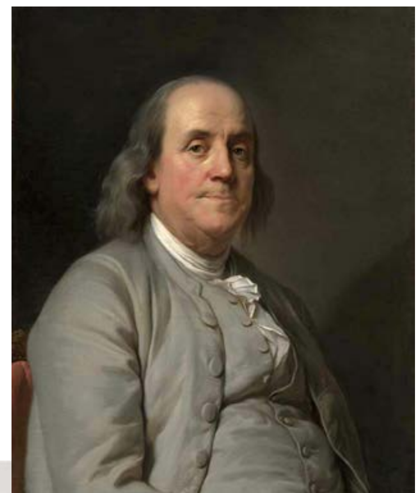



BLACKROCK

TRIVIA QUIZ

HOW MUCH DO YOU KNOW ABOUT FINANCIAL HISTORY?

1. What phrase was printed on early American currency as an anti-counterfeiting device?
2. What famous American inventor and diplomat also designed and printed currency in the 18th century?
3. What document is considered to be the financial equivalent of the US Constitution?
4. According to the 1792 Treasury Department Circular, the US State Department had a staff of five and the US Department of War had a staff of three. How many staff members did the US Treasury Department have that year?
5. Who did President Thomas Jefferson appoint as Secretary of the Treasury in 1801?
6. What country was home to the world's first documented commercial oil well?
7. What is the Economic Cooperation Act of 1948 more commonly known as?
8. At what 1896 event did William Jennings Bryan publicly declare, "You shall not crucify mankind upon a cross of gold!"
9. What NYSE-listed retail company was founded in Scottsville, Kentucky, in 1939?
10. At what age did Warren Buffett make his first investment?



1. Death to counterfeit **2.** Benjamin Franklin **3.** Alexander Hamilton's *Report on the Public Credit* **4.** 53 **5.** Albert Gallatin **6.** Canada **7.** The Marshall Plan **8.** The Democratic National Convention **9.** Dollar General **10.** 11

In Defense of Capitalism Part IV: The Promise and the Peril

By Brian Grinder and Dan Cooper

"Commerce, which has enriched the citizens of England, has contributed to their freedom, and this freedom has in turn stimulated commerce…Posterity will perhaps be surprised to learn that a small island that had but little lead, tin, fuller's earth, and coarse wool, became by its commerce powerful enough in 1723 to send three fleets at the same time to three separate parts of the globe… All this is cause for justifiable pride to an English merchant and allows him to compare himself, not without reason, to a Roman citizen. Indeed, the younger son of a peer of the realm is not disdainful of commerce. Lord Townshend, a minister of state, has a brother who is content to be a London merchant. At the time when Milord Oxford governed England, his younger brother was a business agent in Aleppo, whence he did not wish to return and where he died."

— Voltaire

The Promise

Throughout his career, the late Hans Rosling expressed amazement at the general lack of understanding of the current state of the world. Rosling went around the world asking questions, based on statistics from the United Nations and the World Bank, to people from all walks of life. Most of them were unable to answer his questions correctly. Consider the following question from Rosling's posthumously published book, *Factfulness*.

In the last 20 years, the proportion of the world population living in extreme poverty has:

A. Almost doubled
B. Remained more or less the same
C. Almost halved

According to Rosling, only 7% of the people asked knew that the proportion of the world population living in extreme poverty has almost halved in the last 20 years. Most did not know that the majority of the world population now lives in middle-income countries, that 80% of the world's population has some access to electricity and that the average life expectancy in the world today is 70 years.

Rosling attributed such ignorance to our preference for negative news stories. "Stories about gradual improvements," he noted, "rarely make the front page even when they occur on a dramatic scale and impact millions of people." It is amazing that Rosling never mentioned capitalism's role in our improving world environment, but its contribution to improving life for millions is incontrovertible.

For most of recorded history, according to economist Deirdre McCloskey, the average person consumed about $3 a day. Today, the average person consumes about $30 a day. "The heart of the matter," she declares, "is 16. Real income per head nowadays exceeds that around 1700 or 1800 in, say, Britain and in other countries that have experienced modern economic growth by such a large factor as 16, at least." This economic miracle is the direct result of capitalism.

McCloskey argues that the miracle began in Holland where society's elites finally began to accept the idea that honor and dignity could be ascribed to a career in business. "It became honorable…to invent a machine for making screws or to venture in trade to Cathay." This great "Revaluation," as McCloskey terms it, was the spark that set off the capitalist revolution, which spread to England, Scotland and France.

Philosopher Michael Novak posited that, "Of all the systems of political economy which have shaped our history, none has so revolutionized ordinary expectations of human life—lengthened the life span, made the elimination of poverty and famine thinkable, enlarged the range of human choice—as democratic capitalism." This is the great promise of capitalism, a promise that continues to this day.

The Austrian economist Friedrich Hayek (1899–1992) understood capitalism's uncanny ability to raise living standards. However, as journalist John Cassidy

Hulton Archive/Getty Images

Photograph of Austrian economist Friedrich Hayek, circa 1950. Hayek understood capitalism's ability to raise living standards and also realized capitalism does not work in every situation.

points out, Hayek also knew that capitalism does not work in every situation. The successful foundation needed for capitalism to thrive includes: (1) "the existence of a generally accepted set of social norms (among them the sanctity of private property)," (2) "a system of laws reflecting these norms" and (3) a government that enforces those laws fairly.

Cassidy points to the collapse of communism as a case in point for testing Hayek's three preconditions. He notes that in Hungary, Poland and Czechoslovakia, collectivist economies were quickly transformed into capitalist economies. According to Cassidy, this was accomplished because capitalism, which predated communism in these countries, had already established the rule of law, and private contracts were generally recognized by their respective governments. Such a transformation was stymied in Russia, "where capitalism had never taken root, legal contracts were an alien tradition and official corruption was rampant." The Arab Spring of 2010, which many thought would result in a capitalist transformation in the Middle East, also failed largely because of the absence of Hayek's three preconditions for capitalistic thriving.

The Peril

Capitalism has never received divine sanction or blessing. It is an economic institution devised by humankind, and it works reasonably well under the right circumstances. Therein lies the peril. Capitalism, like any institution, can fail.

Internally, capitalism faces the challenge of maintaining its Hayekian foundation. Fortunately, this strong foundation has weathered many storms and proven to be resilient. The Great Depression (1929–1939) and the Great Recession (2007–2009) both dealt near fatal blows to capitalism, but the system was able to adapt, revive and thrive through these difficult periods.

During the Roaring 20s, societal norms experienced dramatic changes that were often fueled by errant monetary policy. The communist experiment in the Soviet Union, which seemed to be working, caused many to wonder if a government-controlled economy was preferable to capitalism. Depression era government intervention, such as the National Industrial Recovery Act (NIRA) of 1933, threatened to undermine free markets and fundamentally change how government regulated industry.

Prior to the Great Recession, societal norms and government policies again combined to threaten capitalism. Ethical standards took a back seat as greed fueled the pursuit of increasingly shaky

Johan Eriksson for Dollar Street

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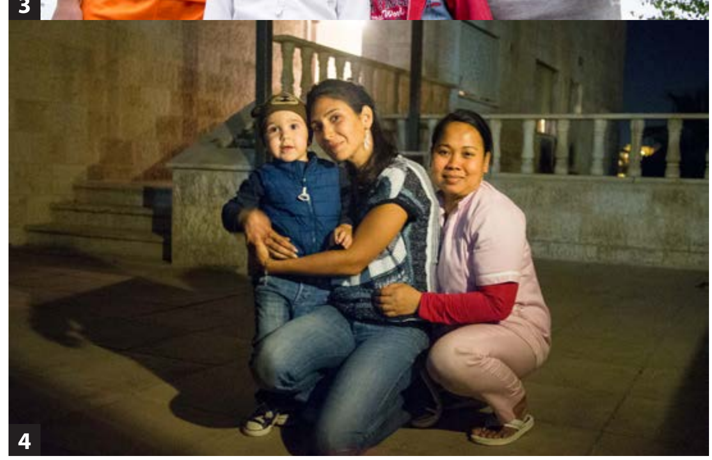
Zoriah Miller for Dollar Street



Zoriah Miller for Dollar Street

The photographs on pages 12–13 are from Dollar Street, the brain child of Anna Rosling, daughter-in-law of the late Swedish professor, Hans Rosling. Dollar Street features photographs from 300+ homes in 52 countries and orders them by income. The dollar values below represent the monthly consumption amount available to each adult member of the household shown in the photograph. More information on Dollar Street can be found at www.gapminder.org/dollar-street.

1. Burundi, $27
2. India, $221
3. Ukraine, $10,090
4. Jordan, $7,433
5. China, $730
6. Haiti, $39
7. Brazil, $685
8. United States, $4,446

5 Jonathan Taylor for Dollar Street

6 Zoriah Miller for Dollar Street

7 Leony Carvalho for Dollar Street

8 Sarah Diamond for Dollar Street

profits. Government regulators either failed to notice or simply ignored abusive behavior in real estate, banking and finance. Furthermore, government policies encouraging home ownership, while well intended, encouraged extreme misbehavior in the mortgage markets. The cost of all these misdeeds was enormous.

Critics did not hesitate to unfairly characterize capitalism as the primary cause of the Great Recession. The Occupy Wall Street movement reflected growing dissatisfaction with capitalism in the Great Recession's aftermath. Although this movement has largely dissipated, skepticism about capitalism continues unabated as seen in the surprising strength of Senator Bernie Sanders's 2016 presidential campaign and the rising popularity of congressional candidates, such as socialist Alexandra Ocario-Cortez.

The great promise of capitalism has been demonstrated time and again in the lives of countless individuals who have been lifted out of poverty into a standard of living never before seen or imagined prior to its advent. Capitalism is not a perfect economic system, and it has been abused by unscrupulous participants with great regularity. However, it encourages and rewards honest initiative and innovation and requires minimal governmental oversight.

In order for capitalism to survive, we must reexamine and affirm the important ethical standards and norms under which businesses operate, we must recommit ourselves to principles that protect private property, we must support laws that reflect those standards and principles, and we must ensure the fair and proper enforcement of those laws. The alternative is to sink into an economic malaise that all too often ends in despotism and tyranny.

More importantly, the benefits of capitalism must be taught without bias in our educational system. For far too long our children have been indoctrinated with the false belief that the evil capitalistic system makes the poor poorer and the rich richer. The good news about capitalism doesn't make for dramatic headlines, but the evidence is everywhere around us. We need only to stop and examine the facts. $

Brian Grinder is a professor at Eastern Washington University and a member of Financial History*'s editorial board. Dr. Dan Cooper is the president of Active Learning Technologies.*

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ANNUAL SHAREHOLDER MEETINGS

From Populist to Virtual

By Lawrence A. Cunningham and Stephanie Cuba

The 1933 annual meeting of Exxon-Mobil, then Standard Oil of New Jersey and among the world's oldest and largest corporations, was a gathering of five people at a New Jersey gas station. By 1977, the company's annual meeting filled the 2,000-seat Houston Music Hall and in 2018 still draws thousands to a similar Dallas venue.

These dramatically different attendance numbers point us to the history of the corporate meeting. Chief protagonists are John and Lewis Gilbert, brothers who chose fighting for shareholder rights as their life's work. Their motives appear in Lewis Gilbert's portrayal of the problem in his 1956 book, *Dividend and Democracy*:

> In 1932, the typical annual meeting, often tucked away in some remote rural hideaway, was usually attended by no more than a silent dispirited baker's dozen who listlessly listened to the mechanical legal jargon by which insiders re-elected themselves to do as they pleased.

Through the 1930s, large US corporations were owned mostly by a small number of influential banks, financiers and dynasties, such as Morgan, Rockefeller and Vanderbilt. But as the Great Depression stoked suspicions of concentrated corporate power, Congress passed banking, securities and tax laws that fostered diffuse share ownership.

Individuals nationwide came to own stock in American companies, and the Gilberts spent five decades advocating for them. Their legacy of shareholder engagement endures, though the US shareholder base since 1980 re-concentrated, with rising ownership by pension funds, mutual funds and other institutions.

The legacy is relevant to emerging debates over whether annual meetings should continue to be held in-person anymore, or instead solely online, as several public companies have recently begun doing. This modern development stirs debate about the purpose and value of shareholder meetings. History sheds light on the stakes.

Shareholders gather ahead of the Berkshire Hathaway annual meeting in Omaha, Nebraska, on Saturday, May 5, 2018.

The Populist Quest for Shareholder Democracy

From 1940 to 1979, as individuals steadily came to own more and more corporate equity, the annual meeting grew increasingly engaging. While only a small percentage of shareholders attended, and a minority of those spoke up, they helped forge a shareholder-centric orientation across corporate America.

The Gilbert brothers and fellow advocates put proposals on the meeting agenda for a vote, posed pointed questions to senior managers during the proceedings and then publicized their progress widely. All were media savvy, spreading their mission in articles and books, on radio and television, and through public lectures and Congressional testimony.

The Gilberts were known as the deans of the professional shareholders. Throughout this period, the brothers personally attended as many as 300 annual meetings yearly and covered another 50 with a small staff of associates. Legatees of an estate whose assets included small stakes in some 600 public companies, the two lived in a fashionable apartment building on Manhattan's Upper East Side.

The Gilberts' persistence and logic won them many governance reforms over five decades, ranging from confidentiality in shareholder voting to the rise of outside directors. As early as 1947, they gained a tactical advantage after pushing shareholder proposals at Transamerica to have shareholders choose the auditors and for a post-meeting transcript. In ordering the company to comply, an influential court opinion famously explained, "A corporation is run for the benefit of its stockholders, not for that of its managers."

Annually from 1940 to 1979, the Gilberts published a book-length account of the major annual meetings and related issues of the day. Entitled "Annual Reports on Stockholder Activities at Corporation Meetings," the Gilbert volumes were published in limited quantities—print runs of 8,500 in earlier years and 6,000 in later ones—and are today collectors' items.[1]

The reports were astonishingly consistent, opening with 20 pages of photographs from the year's meetings; a brief useful glossary; a consciously-compact average of about 265 pages of narrative text; an index of companies; and, most impressively, a substantially identical table of contents (see Figure 1).

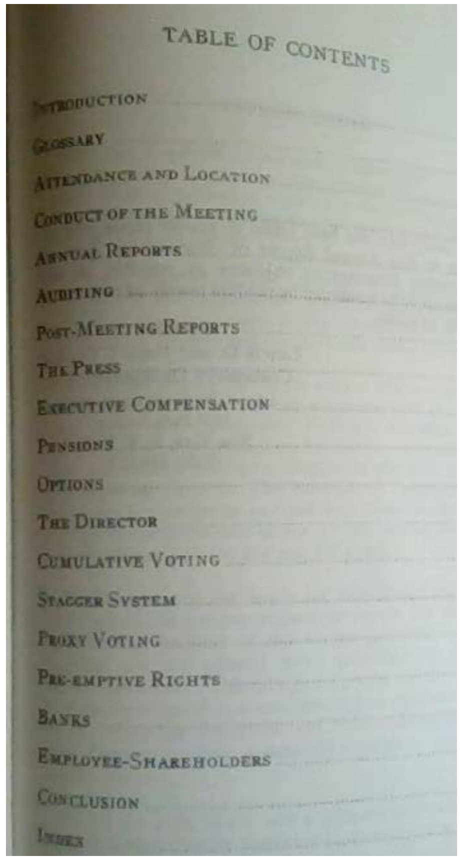
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Figure 1: The standard table of contents appearing in the Gilbert brothers' annual report on shareholder meetings.

The books and meeting attendance had one overriding purpose: to promote "people's capitalism." By 1954, they had already made substantial progress. As put by a distinguished contemporary establishment figure, Covington Hardee, who served as general counsel of Union Pacific Railroad and later CEO of Lincoln Savings Bank, the Gilberts were waging a "remarkable campaign" for "shareholder democracy."

Hardee credits the Gilberts with making the annual meeting a meaningful forum to present shareholder opinion and influence managerial action. They made it a priority to have meetings held in rational locations—locales with a high concentration of shareholders, major urban settings with good local transportation, near company facilities and, for some companies, rotating across a series of cities. They advocated for adequate seating, including overflow rooms, and closed-circuit TVs, and for meeting transcripts to be circulated afterwards, including identification of those posing questions from the floor to facilitate shareholder coordination.

The Gilberts argued for cumulative voting, preemptive rights and annual financial audits, and against staggered boards. They scrutinized executive pay and urged periodic shareholder approval of incentive bonus plans. They were vociferous critics of stock options for managers and opposed employee stock ownership plans (ESOPs) overseen by managerial trustees. Hardee rightly described the Gilbert reports as "absorbing reading" and, while containing "a certain brashness of tone, such a gadfly for management is useful."

Discussion explores dozens of specific meetings to animate the prevailing attitude of managers and shareholders. Striking is how similar debates rage today, including: the pros and cons of staggered boards (continuity versus accountability); age limits for directors (the Gilberts favored mandatory retirement at age 72); separating or combining the chairman and CEO roles (the Gilberts urged separating); "over-boarding" (directors not sitting on too many boards); and proxy voting (from shareholder nominations of directors to the possibility of shareholders voting no for specific directors).

The Gilberts—and fellow gadflies—rated companies on many aspects of shareholder democracy. As to the conduct of meetings, they graded chairmen on the degree of conformity to *Robert's Rules of Order*, the bible of parliamentary procedures, though it is not required by law. Among the era's leading experts on *Robert's Rules* was the Gilberts' friend and fellow activist Wilma Soss, who in 1947 founded the Federation of Women Shareholders of American Business and for many decades hosted a popular NBC radio show called "Pocketbook News."

At shareholder meetings, when chairmen would silence Soss for being "out of order," she would cite specific passages from *Robert's Rules* to explain that it was not she who was out of order. If the Gilberts veered urbane and diplomatic, Soss had a reputation for antics and impudence. Soss made her point about shareholder voice a dramatic one, by bringing megaphones to meetings, and a literal one, by demanding that microphones be placed throughout meeting halls.

A 1951 profile of Soss in *The New Yorker* criticized her incendiary behavior, but for a woman of that era and in that context, her tactics were far more effective than would have been following the Gilbert

style. And although Soss drew criticism for her acid comments, she earned enormous respect as well. A front-page *Wall Street Journal* article in 1963 highlights her blistering critique of IBM's skimpy post-meeting report along with a resolution requiring more detail. In response, Chairman Thomas Watson Jr. invited her to IBM's headquarters, where he accepted her proposal.

By the early 1960s, the Gilberts bragged in their annual reports of many impressive turnouts: up to 10 meetings drew more than 1,000; two dozen between 300 and 900; and AT&T, a bellwether boasting millions of shareholders, set the era's record at 12,000. A 1964 *New York Times* story reported: "The vociferous minority shareholders helped popularize meetings by their persistent attendance and their keen questioning on controversial matters." The Gilberts, who devoted a section of their reports to press coverage, declared in 1965: "The press throughout the nation showed a growing interest in what takes place at the annual meeting."

New Yorker columnist John Brooks reported on several annual meetings in 1966. Altogether, he found the action lively and unruly, laced with ill-mannered verbal dueling and removal of hecklers. But he also heard substantial dialogue that put a human face on corporate executives and shareholders. His chief takeaway: professional shareholders helped reveal executive personalities, as the Q&A "brought the companies to life."

Calvin Trillin made the rounds in 1972, reporting in *The New Yorker* a more cynical synthesis of the era's quest for shareholder democracy. Critics saw the gadflies as abetting a charade, under the pretense that shareholders exercised control, serving management by projecting the false appearance of democracy. But while most shareholder proposals garnered few votes and rarely passed, in aggregate over those decades the gadflies—along with management—made shareholder primacy the norm in corporate life.

Trillin also noted the arrival of a different breed of activists at the annual meeting, focused on social responsibility. They first appeared in 1967 at the Eastman Kodak meeting, where Saul Alinsky challenged its minority hiring practices and, after debate, the company agreed to reforms. The approach gathered force throughout the 1970s, as social activists won court rulings drawing on earlier victories by the Gilberts, insisting that management put shareholder proposals on diverse subjects to a vote "to give true vitality to the concept of corporate democracy."

The Project for Corporate Responsibility emerged, mounting its famous Campaign GM, which used shareholder proposals and the annual meeting on behalf of the rights of others stakeholders, just as the gadflies had in the name of shareholders. Ralph Nader advanced the interests of consumers against corporations through annual meetings as well. Shareholder activist Evelyn Davis rose to fame during this period, though running counter to the social activists and sometimes against the Gilberts and Soss. For instance, she repeatedly offered shareholder proposals to prohibit corporate donations to charitable organizations.

Amid this activism, proposals arose to abolish annual meetings. Proponents argued they were no longer useful to corporations; "crushing bores," was a common description. In 1972, Delaware, a leading state of incorporation, updated its law to let shareholders act by written consent rather than at meetings. In a *New York Times* op-ed, J.B. Fuqua of Fuqua Industries

Wilma Soss Papers, American Heritage Center, University of Wyoming.

Wilma Soss (left) and Lewis Gilbert (right) at the 1957 New York Central annual meeting.

Wilma Soss Collection, Box 8, "Photographs, 1930–1986," American Heritage Center, University of Wyoming.

Wilma Soss speaks into a megaphone at the 1956 New York Central annual meeting. The woman behind her is Emma Chambers Maitland, a "professional wrestler/entertainer" who Soss hired as her "bodyguard."

advocated for abolition, in favor of voting by mail. But shareholders overwhelmingly pushed back and stock exchanges ruled that the consent method did not meet their requirement to have an annual meeting.

Virtually no corporate leaders concurred with Fuqua, and by 1975 *The New York Times* called his cause "notably unsuccessful." By then, corporate America has clearly sided with the Gilberts. NYSE Chairman James J. Needham explained that the annual meeting is "the basic forum of shareholder democracy and an important stimulus to candid corporate self-analysis." The head of Houdaille Industries, Gerald C. Saltarelli, elaborated: "Shareholders should have the opportunity to personally question the management on company affairs and to obtain answers. [T]his questioning forces a discipline upon management to prepare for them and to re-think the company's past performance from a shareholder's standpoint."

In a 1976 article, the general counsel of DuPont, Donald E. Pease, later a professor at Delaware Law School, advised: "The annual meeting serves a practical purpose for two reasons. First, it is necessary to preserve the 'legend' of corporate democracy and the elimination of the annual meeting could cause the introduction of restrictive and undesirable legislation. Second, the annual meeting imposes a discipline on management because it is in effect, an annual audit of management's stewardship of the business."

The Gilberts announced in their 1979 report that it would be their last, and they left the stage having succeeded in making the annual meeting an important forum and holding managers accountable to shareholders. They helped professionalize the fields of investor relations and corporate governance, manifest in the founding of numerous periodicals in this era that continue today, such as *Directors & Boards* and *NACD Directorship*. Their contributions endure, even as the era of the individual shareholder seeking a voice in corporate affairs was dwarfed by powerful institutions more capable of holding managerial feet to the fire.

Institutional Ownership and Corporate Identity

From 1980 through 2010, as ownership of public company equity shifted from individuals to institutions, the prevailing shareholder-manager power dynamic changed. During this era, companies increasingly communicated to shareholders throughout the year, always at regular quarterly intervals and often more frequently, approaching a continuous disclosure model.

Yet while ownership and communication changed, the annual meeting remained a staple of corporate life, an important opportunity for shareholders—both individuals and representatives of institutions—to meet management, pose questions, press issues and resolve debate.

But if the prior era's annual meetings stressed individual shareholders and associated "democratic" rights, this one increasingly brought out corporate identity and culture. For example, Ben & Jerry's Homemade, from 1984 until its sale to Unilever in 2000, attracted a crew of socially responsible owners to a meeting that looked more like Woodstock than Wall Street.

Held among cattle farms near Burlington, Vermont, the founders ran the meeting informally, weaving in the vocabulary of hipsters: co-founder Jerry Greenfield might intone, "Hey, man, time for a little Q&A." The company's commitment

to sustainable profitability, and social responsibility through charitable giving, resonated with this group, while outside shareholder advocates cringed. Pressed by critics on board authority to allocate corporate profits to charitable causes, co-founder Ben Cohen explained:

> We've never taken a formal vote of all the shareholders, but at our annual meetings, I usually ask them—just a show of hands, it's nonbinding—if they support the company's supporting the community and giving away what are really their profits. And they're all in favor of it.

The Ben & Jerry's annual meeting was part of the company's branding—achieved at low expense and producing considerable returns.

Meanwhile, in Omaha, Nebraska, Warren Buffett began building what would become the most popular annual shareholder meeting ever at Berkshire Hathaway. In 1975, a dozen attended in an office cafeteria, but then for three decades added a digit each—hundreds by 1985, thousands by 1995 and tens of thousands by 2005. In 2018, more than 40,000 attended, the record for a US public company, at the largest convention center in town. The Berkshire meeting's main feature has long been a six-hour Q&A with Buffett and Vice Chairman Charlie Munger.

But the Berkshire meeting has evolved into a three-day weekend extravaganza. The company has for decades hosted events on the days surrounding the meeting—a Friday night ball game, Saturday evening cookout, Sunday champagne brunch—and shareholders have added their own side-meetings, panels and speakers that alone draw hundreds or thousands. As recounted in an edited collection of essays, *The Warren Buffett Shareholder*, it is a series of energetic scenes of manager-owner partnership, a people's capitalism the gadflies would love.

Another mighty midwestern town, Fayetteville, Arkansas, has been the scene of the Walmart stockholders' meeting, most distinctive because of its conscious focus on employees. While founder Sam Walton hosted the first Walmart Stores annual meeting in 1970 at a coffee shop with five other people, throughout the 1980s, the meetings have added special events and celebrity guests to draw ever-larger crowds. The venue has moved from the headquarters auditorium to University of Arkansas arenas now seating 20,000.

Wilma Soss Papers, American Heritage Center, University of Wyoming.

Gadfly Lewis Gilbert at an annual shareholder meeting.

Walmart executives bound onto stage amid flashes of light and sound, met with roars of crowd approval. Managers get the crowd to spell out Walmart, declare that the store is number one and proclaim their love of the brand. Though Walmart remains an economic powerhouse serving its shareholders well, its identity is in its employees, which it affectionately refers to as "associates." The annual meeting is their centerpiece.

During this era, the corporate annual meeting also became a stage for drama. Many examples appear in a memoir by Randy Cepuch, based on visits to 50 annual meetings from 2002 to 2006. He captures poignant moments revealing the personalities behind corporate cultures: when Roy Disney and Stanley Gold led the ouster of Disney CEO Mike Eisner, and when Sandy Weill ended his amazing run at the helm of Citigroup to an enraptured group of applauding shareholders. The fate of Dow Jones was shaped at its annual meeting, including a persuasive argument made by noted value investor Mark Boyar that the Bancroft family should sell.

Savvy managers today use the annual meeting to attract shareholders they desire—especially important for managers with long time-horizons seeking patient capital. At an annual meeting of Southeastern Asset Management, this enabled Chairman O. Mason Hawkins to boast: "We have the best shareholders in the mutual fund business." The claim has rivals, such as Ruane Cunniff, which runs the famed Sequoia Fund. It cultivates intelligent long-term investors, attracting and retaining them in part through its annual meetings that draws a regular group of 1,000 in early May to New York's Plaza Hotel.

Today and Tomorrow: The Virtual Meeting?

Since 2010, several large public companies have held annual shareholders meeting solely by electronic means, not convening in a physical location, a so-called virtual-only meeting. Many had for several years supplemented annual meetings with digital feeds—such as Cisco System dating to 2005—and most others followed suit, including Berkshire Hathaway from 2016. But even now only a small fraction host remote-only annual meetings, amid controversy.

Authorization to host virtual-only shareholder meetings was first enacted in 2000 by Delaware corporate law. Today, most state corporate laws permit the practice. (Both federal law and stock exchange rules have tended to defer to state law on the manner of holding annual meetings.) In the first decade, a smattering of mostly-smaller companies opted in. They were led by such names as Ciber, ICU Medical and Inforte, and followed by the likes of Adaptec, Herman Miller and UAP Holding.

During this period, a few big names put their toe in the water only to retreat under

shareholder objection—CSRA, Conoco Phillips, Siebel, Symantec and Union Pacific Railroad—while others overcame or overlooked shareholder resistance—Comcast, Duke Energy, Intel, PayPal and Warner Music Group.

Proponents cite several advantages for virtual-only shareholder annual meetings. These start with lower costs, potentially increasing the number of shareholders tuning in, and a cost-benefit framework that stresses that few attend and little occurs. A related advantage argues that institutional owners cannot attend all the meetings where they own stock because their portfolios are so diversified while ability to tune-in increases coverage. A final asserted benefit notes that virtual annual meetings are not much different from quarterly conference calls.

Skeptics counter each point, especially the assertion that the meeting is a mere formality not worth the cost. As history suggests, engaged managers and shareholders have made the meetings productive. The virtual-only format is unlikely to produce gains like those from the Gilberts and Soss pressing managers, or Ben & Jerry and Warren & Charlie meeting their shareholders. Poor turnout and banality are not reasons to abandon the meeting, but rather rationales to reinvest in it to realize its historical promise. $

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Note

1. The Library of Congress holds volumes 1951 through 1974, but they do not circulate; the New York Public Library holds volumes 1946 through 1968, though at its off-storage site available only to New York State residents; and the George Washington University Law Library holds 1959 through 1979 (other than 1962 and 1971). They are not widely offered for sale online.

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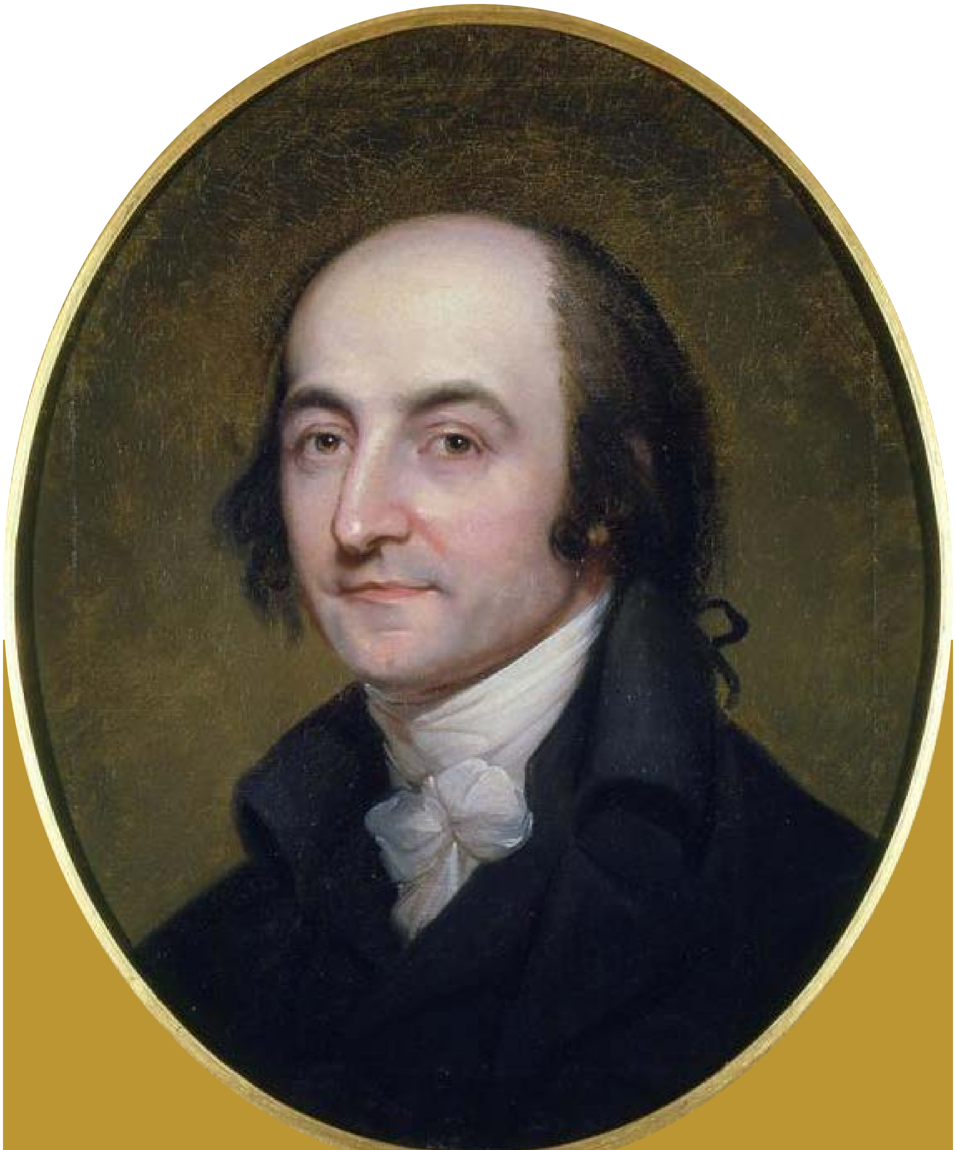


Independence National Historical Park

Albert Gallatin by
Rembrandt Peale, 1805.

Albert Gallatin *and a Nation Free from Debt*

By Gregory May

When Thomas Jefferson appointed Albert Gallatin to be Secretary of the Treasury in the spring of 1801, the Treasury was by far the largest department of the federal government. Seventy-three of the 127 executive officials in Washington worked for the Treasury, and the 1,200 revenue officers in the rest of the country were the government's largest civilian work force. The Washington staff worked in a hastily constructed brick building just east of the President's House, where the vastly larger Treasury building stands today. The two-story structure had 16 rooms on each floor, laid out along intersecting central hallways, and it already felt crowded. A fire that began behind a shoddily-built fireplace had destroyed some records a few months earlier, and Jeffersonian Republicans muttered that the Federalists had set the fire to stop an inquiry into the outgoing Federalist administration's misuse of federal money. The House of Representatives had investigated. But because the flames had destroyed the relevant account books, the evidence of shoddy construction had not dispelled suspicion.

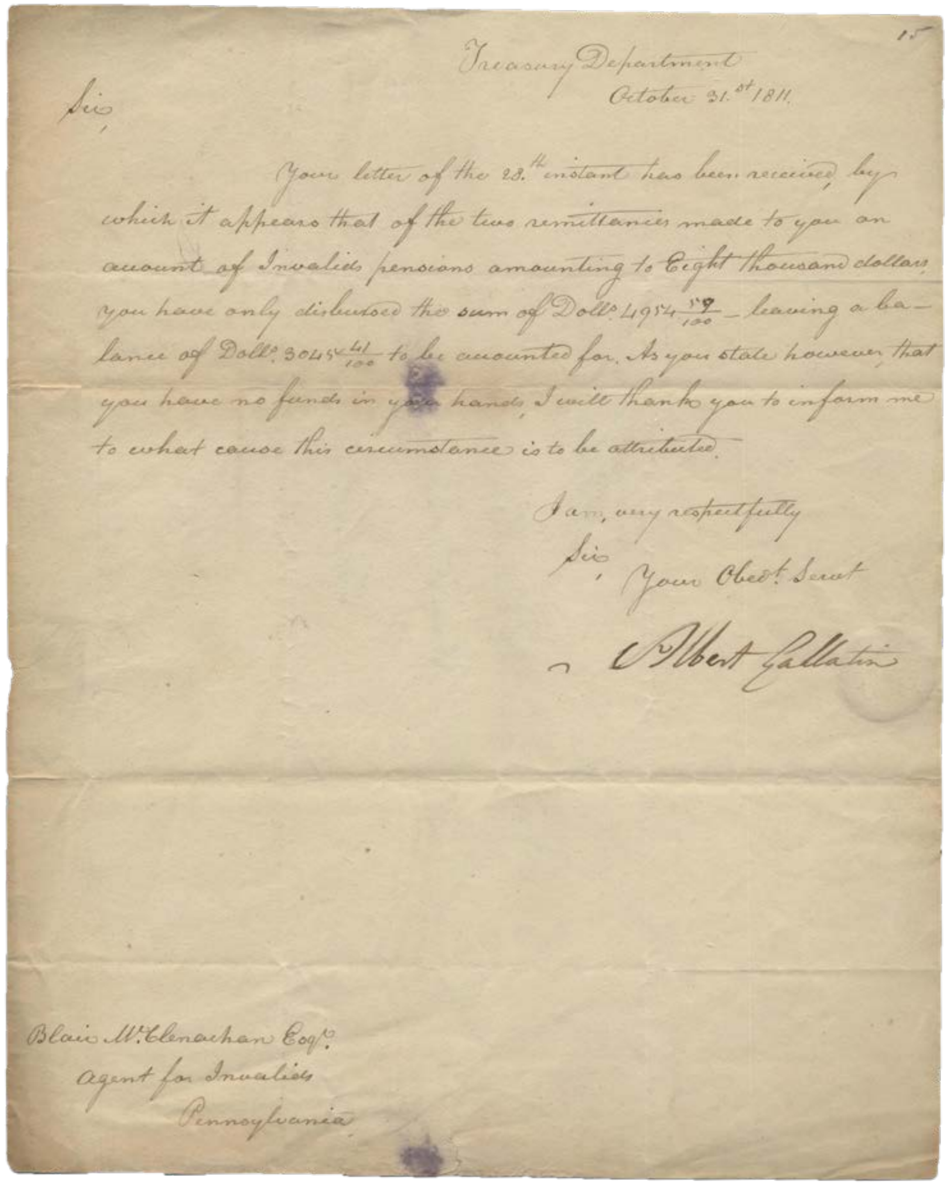
The Republican opposition to the Federalist regime had arisen from more fundamental suspicions about what went on at the Treasury, and it was clear that Gallatin would play a central role in the new government. Jefferson epitomized the new administration's objectives in his call for "a government rigorously frugal & simple, applying all the possible savings of the public revenue to the discharge of the public debt." Whether Jefferson's administration could keep that promise depended on Gallatin. He was the only leading Republican with demonstrated expertise in public finance. And although Federalists and even some Republicans criticized him for jockeying his way into the Treasury post, none of them doubted his ability or offered an alternative candidate.

Gallatin and his family took a house on Capitol Hill, and Gallatin usually rode to the Treasury along the ridge down F Street to avoid the soggy causeway called Pennsylvania Avenue. His physical appearance did not impress anyone. He was 40 years old, and a lean man of above average height. But he had never been handsome, and he was now growing bald and a bit stooped. A Federalist senator complained that he was "very inattentive

of his person & dress—his linen is often soiled & his clothes tattered." That may have been an exaggeration, but Gallatin's homeliness and his reputation for thrift encouraged such exaggerations. Even his smoking habits became the stuff of fable. He stopped buying cigars in bulk, a Congressman reported, because he found that he smoked fewer and spent less if he bought only a quarter's worth at a time.

Gallatin's thrift became legendary because he slashed federal spending to find the money he needed to repay the national debt. During his years as an opposition leader in Congress, Gallatin had dismissed Alexander Hamilton's plan for repaying the debt. Hamilton's plan used revenues from specific taxes to pay interest on particular bonds, all subject to a variety of contingencies. It also allocated surpluses, which had probably never existed and which no one had ever bothered to calculate, to a sinking fund that could repurchase bonds in the market. The plan was complicated and—perhaps intentionally—confusing. Jefferson described it as "a number of scraps & remnants many of which were nothing at all" applied to "different objects in reversion and remainder until the whole system was involved in impenetrable fog." Its purpose was not so much to extinguish the debt as to manipulate repayments and repurchases in order to support the government's credit and increase the price of its bonds.

Gallatin had fundamentally different intentions. The only way the government could reduce its debt, he had repeated throughout his six years in Congress, was to spend less than it received. In the flush of the Republicans' electoral triumph, he set out to do that.



15

Treasury Department
October 31.st 1811.

Sir,

Your letter of the 28.th instant has been received, by which it appears that of the two remittances made to you on account of Invalids pensions amounting to Eight thousand dollars, you have only disbursed the sum of Dolls. 4954 59/100 – leaving a balance of Dolls. 3045 41/100 to be accounted for. As you state however, that you have no funds in your hands, I will thank you to inform me to what cause this circumstance is to be attributed.

I am, very respectfully
Sir,
Your Obedt. Servt
Albert Gallatin

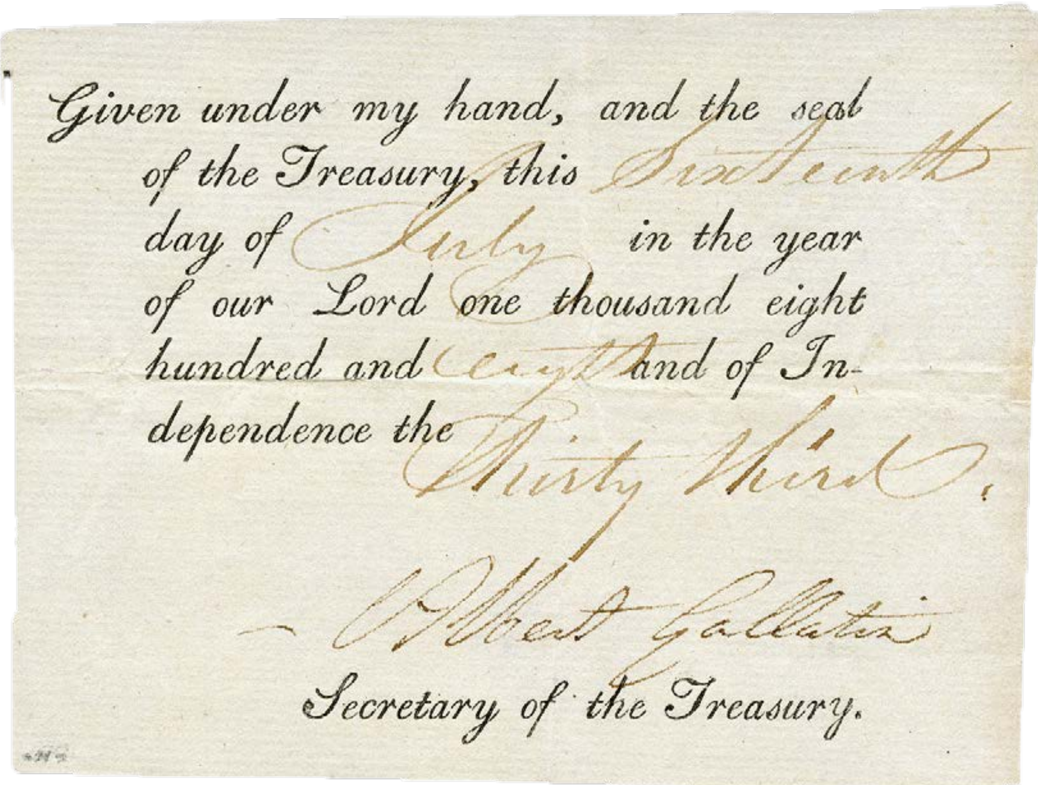
Blair McClenachan Esqr.
agent for Invalids
Pennsylvania

Collection of the Museum of American Finance

Letter from Albert Gallatin to Blair W. Clenachan, Esq., agent and commissioner of loans in Philadelphia, dated October 31, 1811, regarding pension disbursements.

As he set to work on the first Republican budget, Gallatin used straightforward arithmetic. He estimated that federal revenues for the following year would amount to $10.6 million. He liquidated the various existing appropriations for principal and interest on the debt into a definite annual sum of $7.3 million. He determined (with a bit of algebra that both he and Jefferson found difficult) that fixed annual payments of that amount could repay the entire federal debt within 16 years. Since the terms of some of the bonds prevented the government from repaying them any earlier, he adopted the $7.3 million annual payment as the foundation for his budget. That left him $3.3 million to pay government expenses that had averaged $5.8 million over the previous four years. Pressure to repeal Hamilton's excise taxes on whiskey and other goods soon required Gallatin to cut another $650,000 from spending, but he pressed ahead. He thought import duties would raise enough money to pay for peacetime government. Within months Congress had adopted Gallatin's budget and replaced Hamilton's vague debt repayment plan with a $7.3 million fixed annual appropriation that took priority over all other federal spending.

Gallatin's reforms provoked a diatribe from Hamilton that lasted almost as long as it took Congress to enact them. In newspaper essay after essay, Hamilton excoriated Gallatin for pandering to the people and cutting off the government spending that was needed to strengthen the new nation. "Practical politicians," Hamilton said, knew that governments must use their fiscal resources to encourage national prosperity. Gallatin's obsession with debt repayment would "sink the government" by cutting off the money essential to "its respectability," "the accomplishment of its most salutary plans," and "its power of being useful." Indeed, Hamilton sneered, Gallatin's reforms would not even be possible if Hamilton himself had not already stabilized the government's finances by funding the public debt. The reforms were the measures of "LITTLE POLITICIANS, who now...enjoy the benefits of a policy,



Given under my hand, and the seal of the Treasury, this Sixteenth day of July in the year of our Lord one thousand eight hundred and eight and of Independence the Thirty Third.

Albert Gallatin

Secretary of the Treasury.

National Numismatic Collection, National Museum of American History, Smithsonian Institution

Signature of Treasury Secretary Albert Gallatin.

which they had neither the wi[s]dom to plan nor the spirit to adopt."

Gallatin's views on debt and democracy could not have been more different. He and other Republicans thought Hamilton's funded debt endangered freedom and republican government. That belief rested on interlocking economic and political foundations.

The economic foundation for the belief was the orthodox liberal premise—elaborated by Adam Smith and others—that government spending on everything except public improvements consumes a nation's investment capital. As long as a government could spend no more than the people were willing to pay in taxes, there was a salutary natural limit on this consumption. Credit made that limit flexible. But the British funding system that Hamilton had adopted practically demolished the natural limit. It allowed the government to borrow far more than the people were willing to pay in taxes because the people had to pay only enough to cover the annual interest. It prevented the people from understanding how much money the government actually was spending, and that ignorance allowed the government to go deeper and deeper into debt. The federal government already used about 70% of its revenues to pay interest on its debt, and the taxes needed to do that shifted more and more capital from ordinary people into the hands of wealthy creditors. Until the government freed it revenues from this burden, it could not afford to do much of anything without borrowing even more.

That economic analysis supported the Republicans' political critique of funded debt. Hamilton had argued that the public debt would strengthen national government because the public creditors' self-interest would lead them to support the federal regime. The Republicans accepted that prediction, but they thought it was a malediction. True republican government required the participation of the people, and Republicans thought the people could participate more effectively in state and local governments where they were more directly represented. Consolidating power in a distant federal government shifted political control from the people into the hands of wealthy and designing men who ultimately would corrupt the government.

Embedded in the Republicans' economic and political thinking were more visceral beliefs about debt and democracy. Like Adam Smith and other liberal political economists of the time, Republicans thought about public debt in the same way they thought about private debt. They believed that the failure to pay it would bring ruin. And that notion interlocked with an equally visceral belief about democracy. A republican government gave sovereignty to the people, but true popular sovereignty depended on the people's independence—their freedom to act in their own best interests. Economic arrangements that made voters dependent on others—creditors, landlords or employers—compromised their independence. Public debt compromised the government's independence in the same way. A government beholden to its creditors was not truly under popular control. Its people were not wholly free. True freedom depended on frugal government uncorrupted by debt.

Republicans believed that public debt jeopardized not only freedom, but peace. Montesquieu, Rosseau and other Enlightenment thinkers had maintained that monarchies were more warlike than republics because they could shift the physical and economic burdens of war to their subjects. Republics were inherently peaceful because the people who bore the awful burdens of war would avoid armed conflict. Were all nations to become republics, destructive wars would end and universal peace would usher in an era of unparalleled prosperity. Hamilton dismissed this vision as a utopian dream. The best way to avoid war, he had written in *The Federalist*, was to prepare for it.

But Gallatin and Jefferson embraced the vision of republican peace, and they thought Hamilton's system for funding the public debt threatened it. Perhaps it was a "visionary dream," Gallatin had said when he was in Congress, but he hoped America's distance from Europe could allow Americans to avoid conflict and live in peace "without armies and navies, and without being deeply involved in debt." He thought Americans should strive to "become a happy, and not a powerful nation." Running up debt to fund military spending would be a confession that Americans meant to join the great nations of Europe in their wasteful careers of war and destruction. Jefferson took the same view, and he spoke of "peace, economy and riddance of public debt" as a composite objective—each interlocking element dependent on the others. He thought that the best way to keep a country at peace was to deny it the means for waging war. In peacetime, the government should disband its armed forces and rely on the militia for defense. If the government could do without excise taxes, he and Gallatin agreed, it should repeal them because the people would be more willing to pay taxes in wartime if they did not have to bear them in peace.

Whatever the merits of the Republicans' political economic theories, repeal of the Federalists' excise taxes was popular. A crowd in the town soon to be Ohio's capital celebrated the repeal of those "oppressive and odious" measures by consigning the laws to a bonfire and toasting the health of "the present economical administration." Stalwart Republicans like John Taylor of Caroline had never doubted the political importance of tax repeal. A "rigid economy," he wrote shortly after Jefferson's election, would allow the administration to repeal obnoxious taxes, and tax repeal would cement popular support for the new Republican regime. Jefferson's lofty political sentiments were all very well, Taylor told James Monroe a few years later, but it was really just taxes that determined who won American elections.

Debt repayment and tax reduction were popular, but Gallatin pursued those reforms with a single-mindedness that liberal European political economists could scarcely have imagined when they wrote about the fiscal reforms needed in their own countries. Although Hamilton had copied some of the British fiscal arrangements, Hamilton's regime placed a far lighter burden on the American economy than the burdens that had sparked the liberal economic critiques in Europe. Britain and France had a complex variety of taxes on trade, consumption, land and even incomes, and they had accumulated large public debts over almost a century of expensive warfare. Rough estimates suggest that their taxes extracted 7–12% of national income during the late 18th century and that their national debts were 10 to 15 times larger than their annual tax revenues.

America's situation was different. The Revolutionary War and Hamilton's refinancing had saddled the federal government with a debt that was 30 times its annual tax revenue, but the government itself was far smaller, and the federal taxes amounted to only about 2% of national income. State taxes probably accounted for another 2%. The relatively undeveloped country already showed great potential for rapid expansion of population and economic output. So when Jefferson complained that the United States was the most indebted nation in the Atlantic world, he was misjudging the effective burden. Gallatin's sweeping fiscal reforms were—even from the liberal economic perspective—overkill.

Gallatin's excessive frugality had a price. Gallatin was still at the Treasury a decade later when the War of 1812 revealed the flaws in his policy. Gallatin had taken three risks when he reformed Hamilton's system, and the war with Britain brought all three of them home. First, Gallatin's repeal of all excise taxes had narrowed the tax base down to import duties. A narrow tax base was inherently inflexible, and import duties were notoriously vulnerable to wartime disruptions in trade. Gallatin had believed that the people would be more willing to pay excise taxes in wartime if they did not have to pay them in peace, but Congress did not work up the political courage to test that proposition until the skyrocketing costs of the war had already severely damaged the government's credit.

Second, Gallatin had given debt repayment unquestioned priority over military spending, even as the French Revolution and Napoleon's rise to power fueled one of the largest military conflicts in Atlantic history. Because Gallatin and other Republicans believed they could not afford a viable military establishment, they never seriously considered how long the nation could go on without one. When British interference in America's neutral trade with France finally provoked the United States to declare war, the country had only 7,000 soldiers and 17 naval ships.

Finally, Gallatin had expected that a fiscally responsible Treasury could obtain new loans whenever war required extraordinary spending. But Congress' reluctance to raise new taxes and military defeats attributable to inadequate preparations blasted his expectations. He was forced to borrow at deep discounts and, even then, he found less money than he needed to pay for the war.

By the time Gallatin sailed for Europe in 1813 to seek peace with Britain, the future of the Republican regime he had helped to build was cloudy. All three of the American army's attacks on the British in Canada during the previous year had failed. Despite a few spectacular American naval victories, the British navy so thoroughly dominated the American coast that Gallatin could not sail without a British passport. The Republican majority in Congress was about to accept the need for new taxes, but it trembled at the consequences. The people, wrote one of Gallatin's friends in Congress, "will be disgusted with an administration, who have declared war, without ability to conduct it, to a favorable issue; disgrace & taxes will not suit any nation."

Gallatin himself did not survive the debacle. His enemies pushed him out of the Treasury while he was in Europe, and he never again held political office. But despite a brief turn toward more Hamiltonian fiscal policies immediately after the war, the essential elements of Gallatin's policy survived. Twenty years after Gallatin left office, Andrew Jackson would crow that the federal government had repaid the last dollar of its debt. For better or worse, the fiscal culture that Gallatin had nurtured would persist well into the next century. $

Gregory May is the author of Jefferson's Treasure: How Albert Gallatin Saved the New Nation from Debt *(Regnery History, 2018), from which this article has been adapted. He clerked for Justice Powell, practiced corporate tax law in Washington, DC and New York for over 30 years, and he now writes about the history of the Early Republic.*

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Trading pit for buying and selling grain at the Chicago Board of Trade, July 1907.

GRAIN TRAITORS

A History of the US Futures Contract

By Joseph M. Santos

In Frank Norris's 1903 classic, *The Pit: A Story of Chicago,* cornering wheat on the Chicago Board of Trade consumes protagonist Curtis Jadwin. As the world's food supply hangs in the balance, Jadwin buys enormous quantities of futures contracts, a 19th-century financial innovation that enables buyers and sellers to trade a quantity and grade of an underlying asset—wheat, for example—at a specified price and future date. True to the literary Naturalism that *The Pit* exemplifies, the inescapable and indifferent forces of capitalism ultimately breach Jadwin's corner; broken and impoverished, he leaves Chicago to begin again farther west.

The Pit was published posthumously, a year after Norris's untimely passing at age 32. The novel was to be the second in a trilogy, *Epic of the Wheat*, in which Norris was to chronicle production (*The Octopus, a Story of California* [1901]), distribution (*The Pit: A Story of Chicago* [1903]) and consumption (*The Wolf, a Story of Europe*). Born in Chicago in 1870, Norris came of age (in California) when futures trading, and the corners it allegedly provoked, stirred the imaginations of Gilded-Age and Progressive-Era Americans. Norris was no exception. His inspiration for Curtis Jadwin was 28-year-old Joseph Leiter, who failed spectacularly to corner wheat on the Chicago Board of Trade between 1897 and 1898.

Not surprising, perhaps, farmers were deeply suspicious of futures trading, which they equated to gambling—on grain, no less. However, despite literary representations and popular perceptions to the contrary, futures trading well served the nation's grain trade, especially by the mid-19th century, as agriculture moved from subsistence to commercial production. Financing commercial production, storage and transportation required a financial innovation that enabled commercial interests to trade away their price risk to those who preferred to bear it. By the late 19th century, the futures contract met this requirement.

In the early 19th century, short-term sight drafts, written on the credit of merchants, and consignment contracts, written between commission agents and grain dealers, were the instruments of grain-trade finance. For example, an eastern miller who required grain secured a merchant's line of credit in the form of 60- or 90-day sight drafts. Western commission agents attached grain warehouse receipts to these sight drafts and discounted them locally for bank notes, which agents advanced to grain dealers for a portion of the grain's market value at that time; agents paid dealers the remainder when the grain sold in eastern terminal markets.

This system worked well enough when grain prices were mostly stable from harvest to consumption; however, such price stability was rare. During credit crises, hinterland banks often refused to discount sight drafts, depriving the grain trade of it precious credit. The problem was that trading on consignment meant that commercial interests could not trade away price risk. Put differently, financial markets were incomplete; trades that would suit hedgers and speculators alike did not occur for lack of an appropriate market, complete with an institutional framework that sufficiently reduced transaction costs.

Following the Panic of 1857, "the credit

needs of producers were met by the wide use of 'to arrive' contracts." The buyer and seller in a to-arrive contract agreed to a price and quantity of a commodity for future delivery. These bespoke contracts were illiquid and carried counterparty risk. Nevertheless, commercial interests used them to lock in prices, potentially securing credit more easily. To-arrive contracts predate the mid-19th century. Though, not until the 1850s did grain elevators, railroads and a market made by commodity exchanges catalyze the transition from to-arrive to futures contracts.

Grain elevators and railroads enabled bulk grain to be stored and shipped. Prior to these storage and transportation technologies, grain was branded according to its producer and region. Of course, bulk grain needed to be fungible. Commodity exchanges, including those in Detroit (est. 1847); Buffalo, Cleveland and Chicago (est. 1848); and Milwaukee (est. 1849), were well positioned to service this need. Formed as commercial associations, commodity exchanges became collection points for grain, cotton and provisions, which the exchanges inspected, graded and, thus, standardized.

Soon thereafter, exchanges hosted trading in spot and forward markets. The Board of Trade of the City of Chicago (CBT) was the most important of these exchanges. In its first decade, the CBT was a place where members congregated to discuss business concerns. Its first board of directors represented shopkeepers as much as grain merchants. However, in 1859, the Illinois legislature granted the CBT a corporate charter that afforded the exchange the authority of an administrative agency, one that executed and enforced legislative and judicial functions, including certifying grain and grain trades.

On March 27, 1863, the CBT adopted a framework for trading forward contracts on the exchange. Crucially, the framework defined the terms of contract settlement, the fundamental challenge associated with a forward contract. Finding a counterparty with whom to initiate a forward contract was easy; finding the losing counterparty with whom to settle a forward contract was not. In any case, traders could not formally settle forward contracts by offsetting them on the exchange; though evidence of a secondary market in forward contracts suggests speculators were active in these early derivative instruments.

Joe Sohm/Visions of America

Trading floor of the Chicago Board of Trade, 1997.

In May 1865, the CBT introduced trading in futures contracts. The contract specifications essentially mirrored those of common forward contracts that traded on the exchange at that time; thus, the CBT effectively converted select forward contracts into futures contracts. Moreover, the exchange permitted futures trading by members only, set trading times, standardized settlement protocols and required traders to maintain margin accounts. By the mid-1870s, the futures contract was a principal feature of North American commodity marketing. America's fascination with open-outcry trading *in the pit* had begun.

Futures contracts appeared on several other commodity exchanges around the same time. For example, futures contracts derived from cotton appeared on the New York Cotton Exchange around 1870 and the New Orleans Cotton Exchange around 1882. Other examples of 19th-century exchanges that made markets in futures contracts include the Chicago Open Board of Trade, the Duluth Board of Trade, the Kansas City Board of Trade, the Merchant's Exchange of St. Louis, the Milwaukee Chamber of Commerce and the New York Produce Exchange.

Early futures-trading volume was probably quite high, though a paucity of data makes such a claim difficult to substantiate. In the 1870s, the CBT revealed its traders settled over 90% of contracts by offsetting them rather than by delivering grain as the terms of the initial contract specified. According to Thomas Hieronymus, between 1884 and 1889, an annual average of 24 billion bushels of grain-futures traded on all US exchanges combined, or about eight times the annual average amount of grain marketed in those years; the comparable multiple for, say, 1966 to 1970, is four times.

In any case, most late 19th-century futures exchanges lacked a clearinghouse, a defining feature of a modern futures market. A clearinghouse assumes the role of counterparty to each side of every trade: the clearinghouse buys each contract a trader sells and sells each contract a trader buys. Thus, the clearinghouse absorbs counterparty risk, assuring a robust, liquid futures market in which traders could efficiently offset contracts. To ensure its solvency, the clearinghouse reconciles (by marking to market) all margin accounts at the close of each day. Only as of 1925 did a complete clearinghouse facility serve the CBT.

Of course, not everyone viewed futures trading as progress. In particular, many agrarians contended that futures traders manipulated—and, on balance, reduced—commodity prices. Federal and state legislatures and courts often existentially challenged this financial innovation. For example, the so-called Anti-Option movement fought to outlaw trading all manner

of grain-derived time instruments, be they option, forward or futures contracts. In 1892, the Hatch and Washburn Anti-Option bills passed both houses of Congress; each failed narrowly on technicalities of reconciliation.

Perhaps the most colorful and persistent challenge to futures trading and in particular, the CBT, arose from bucket shops. A bucket shop was, in the modern parlance of sports betting, a bookmaker; it enabled anyone to bet on the daily fluctuations of commodity futures prices. In their attempts to appear legitimate—or, at the very least, to appear no less legitimate than commodity exchanges—bucket shops chose names such as the Christie Grain and Stock Company and the Public Grain Exchange. To casual observers (who no doubt observed CBT members frequenting bucket shops), bucket shops and exchanges were one and the same.

In the 1880s, several states, including Illinois, outlawed bucket shops. Consequently, the CBT sought to distinguish itself from these alleged imposters and, most importantly, deny them access to its market-clearing price quotes, without which bucket-shop-styled bookmaking would be impossible. The CBT, bucket shops and the telegraph companies fought in court for decades over the rights to CBT price quotes. In 1905, the Supreme Court sided with the CBT; bucket shops faded away by 1915.

Curiously, despite the bucket shop threat, the anti-option movement and grassroots opposition more generally, futures trading remained largely self-regulated until after World War I. In the late-19th century, those who opposed futures trading sought in vain to outlaw it; a strategy to regulate futures trading was alien to the political landscape in the Gilded Age. In the early 20th century, relatively high commodity prices mollified the opposition. Federal regulation began with the Grain Futures Act (1922) and culminated with the Commodity Futures Trading Act (1974), which established the Commodity Futures Trading Commission.

In the closing paragraph of *The Pit*, Frank Norris chillingly describes Laura's bleak and disturbing last impression of Chicago as she and her husband Curtis leave the city, never to return. She gazes one last time upon the:

> Pile of the Board of Trade building, black, monolithic, crouching on its foundations like a monstrous sphinx with blind eyes, silent, grave—crouching there without a sound, without sign of life, under the night and the drifting veil of rain.

Speculative malpractice enabled by this sphinx and the futures contract it fashioned destroyed Curtis Jadwin, "leaving Death and Ruin in its wake." More troubling still, *The Pit* is a case of art imitating life: recall, the very same sphinx enabled the destruction of Joseph Leiter.

Nevertheless, the 19th-century futures contract was, in essence, a risk-management instrument. Trading futures contracts was, in general, a far less lethal business than classic literary depictions or actual isolated accounts might otherwise suggest. In truth, speculators absorbed price risk that commercial interests, including creditors, would have assumed otherwise. Moreover, this transfer of risk likely reduced the volatility of US grain prices and interest rates. Then as now, the futures contract afforded its willing participants a market in which to speculate or hedge, depending on their financial circumstances and risk preferences. $

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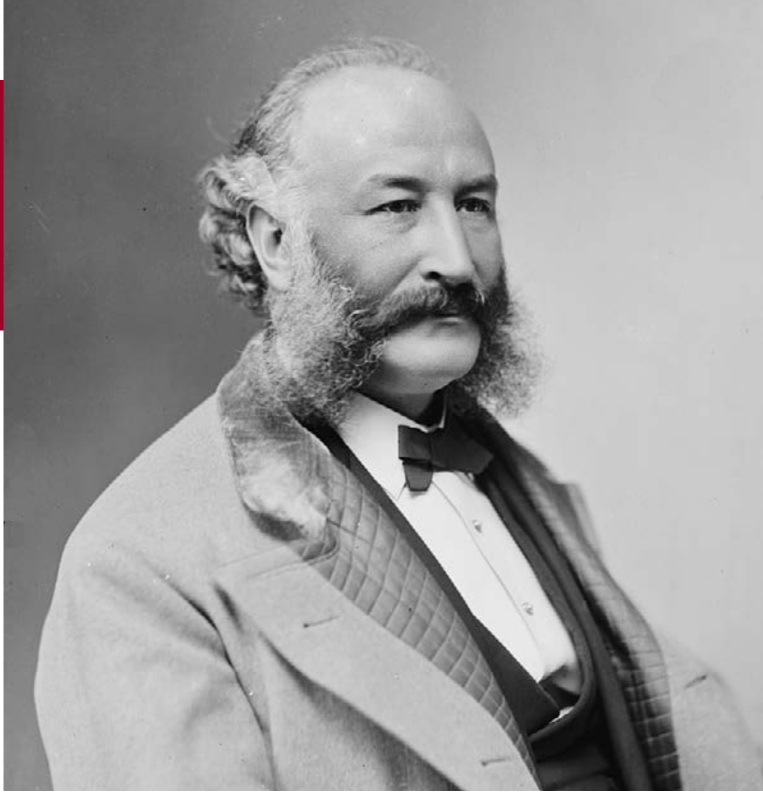

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WHERE ARE THEY NOW?

Sutro & Co.

By Susie J. Pak

The history of the Sutro family in the United States is a varied and illustrious one. One branch featured the San Francisco pioneer, Adolph Heinrich Joseph Sutro (1830–1898). Born in Aix-la-Chapelle, Prussia, Adolph was the son of Emanuel Sutro (1791–1847), a clothing manufacturer, and the former Rosa Warendorff (1803–1883), the daughter of a merchant. After the death of her husband Emanuel in 1847 and the panic that followed the Revolution of 1848, Rosa Sutro immigrated to the United States with her children in 1850. The family moved first to New York and then settled in Baltimore. According to Adolph's brother, Theodore, Adolph moved to California soon after, "having become fired with the gold fever." There Adolph joined his cousin, Herman Frankenheimer, a clothing merchant. Later Adolph established several stores as a tobacconist, naturalized as an American citizen and married in 1856.

In 1860, after the discovery of silver in 1859, Adolph journeyed to Nevada. Capitalizing on his earlier education in mineralogy at a polytechnic school in Germany, he made his fortune by laying a drainage tunnel (called Sutro Tunnel) through Mt. Davidson to the Comstock Lode. It was completed in 1878–79. With the proceeds from his mining investment, Adolph bought vast areas of San Francisco real estate in the late 19th century. In 1895, he was elected mayor of the city.

Portrait of Adolph Heinrich Joseph Sutro, circa 1865–1880.

The founders of the San Francisco house of Sutro & Co. were Adolph Sutro's cousins: Charles, Gustav (also spelled Gustave), Albert and Emil Sutro were also natives of Aix-la-Chapelle. Their father, Simon Sutro, was a banker by trade. Their mother was the former Helena Warendorff. Like Adolph, the Sutro brothers immigrated to the United States, starting with Charles, who then moved to Canada, where he became a tobacconist. In 1852, Charles moved to San Francisco, where he worked for a merchant house and became involved in the mining business. He was joined by his brothers, who also naturalized as American citizens. Together they founded a tobacco and gold-weighing business, which became Sutro & Co.

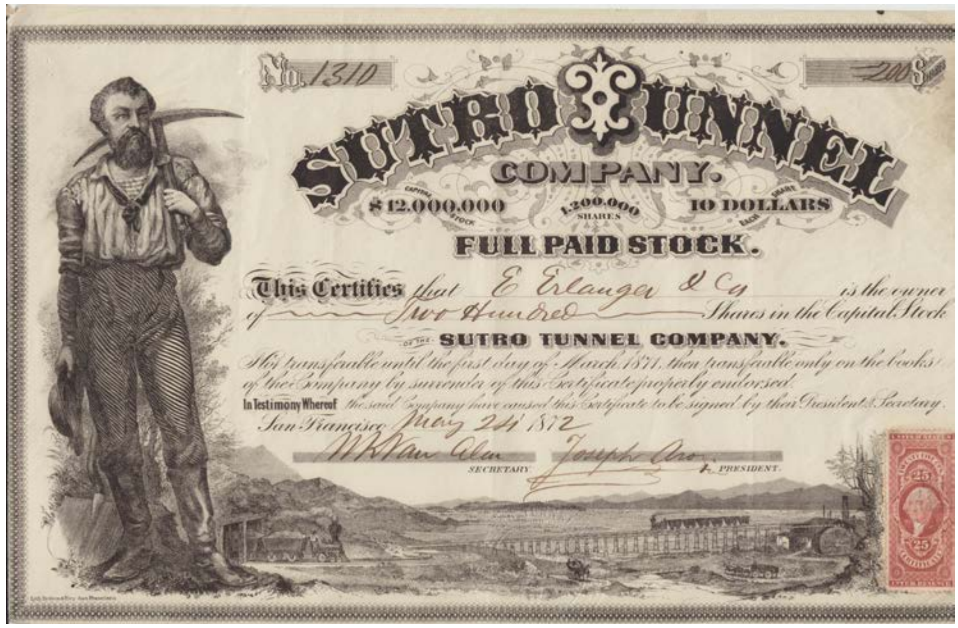
Sutro & Co. (1858)

Though the exact dates of the entry of each brother into the business are unclear, multiple sources suggest that Charles was the first to move to San Francisco and was the guiding force behind the firm. Gustav is often credited with founding the firm with his brother, Charles, but according to Gustav's obituary, he first arrived in San Francisco in 1853 and joined his cousin Adolph's tobacco and cigar business. Gustav then moved to Victoria, British Columbia and lived there until 1870, when he returned to San Francisco and joined Sutro & Co.

According to *The Los Angeles Times*, "In the colorful days of the first decade after gold was discovered in California, the Sutro Brothers engaged in the purchase and sale of gold and exchange and, in a very limited fashion, because of the scarcity of investment securities, conducted a government bond business." In time, the firm became known as one of the oldest brokerage houses on the West Coast and "was one of the original underwriters of bonds for San Francisco's cable cars." It was also one of the charter members of the San Francisco Stock and Bond Exchange (founded in 1882), the predecessor to the San Francisco Stock Exchange.

After the death of Gustav and Charles Sutro, Gustav's son, also named Charles Sutro, became the senior partner. Born in British Columbia, Charles was educated in San Francisco and Germany. In the first decade of the 20th century, the firm continued to add members of the Sutro family. In 1908, Gustav Sutro's daughter, Olga, married lawyer Phillip I. Manson, who joined the partnership. Manson left in 1910 to continue practicing law. In 1910, Gustav's son, Emil, joined the partnership, as did George Lowenberg, Charles Sutro's uncle. By 1928, the firm had grown to seven partners.

1929 was a big year for Sutro & Co. The firm opened an office in Los Angeles,



Sutro Tunnel Company stock certificate, dated May 1872.

Collection of the Museum of American Finance

bought the New York firm of Robinson & Co., a descendant of the firm Fisk & Robinson and joined the New York Stock Exchange. According to *The Los Angeles Times*, it was "the first instance of a Pacific Coast house entering the New York market through the acquisition of the business of a New York Stock Exchange House." Unfortunately, the expansion was organized right before the Crash of 1929. It was also unsuccessful for management reasons and quickly became undone.

In 1930, the firm's floor member, James H. McGean, was suspended from the New York Stock Exchange for three years for "failing to exercise due diligence in preventing improper transactions in the shares of the Manhattan Electrical Supply Company by a customer through one of the firm's branch offices." McGean was similarly suspended from the New York Curb Exchange. Emil Sutro, Gustav Sutro's son, was also suspended for three months from associate membership on the New York Curb Exchange. The eastern partners, most of whom had entered the firm through or after the Robinson & Co. acquisition, retired from the firm. Sutro & Co. also closed its Oakland office and coast branches, keeping only its Los Angeles and San Francisco offices. That year Charles Sutro also retired, and he died of a heart attack the following year.

Charles Sutro was succeeded as senior partner by Sidney L. Schwartz, a University of California, Berkeley graduate and California native who had joined the firm in 1906. The son of William Schwartz, a commission merchant and German immigrant, Schwartz was a nephew of Gustav S. Sutro's daughter, Helen Sutro Schwartz, who married Samuel Schwartz, a merchant in the importer firm of Easton & Schwartz, in 1897. Samuel Schwartz became a partner in Sutro & Co in 1898.

When the firm was reorganized in 1931, Sidney Schwartz led the firm with partners Gustav Sutro Schwartz, Allan Browning Lane, Arthur N. Selby, Emil Sutro, Frank F. Hargear, George M. Lowry, Randolph C. Walker, Howard Greene and Albert B. Sprott. Allan Browning Lane was the son-in-law of Alfred S. Gump, Sidney Schwartz's uncle. (Gump had been a partner in S.&G. Gump Co., an art firm in San Francisco). Lane had formerly been a member of F.J. Lisman, a New York bond dealer, but he joined Sutro & Co. in New York after he married Gump's daughter.

In 1934, Lane and Walker tried "to overthrow the Schwartz management and install Hargear as the managing partner." This move was unsuccessful, and Lane left the firm. His capital in the firm was replaced by several limited partners: Alfred F. Meyer, who later became a general partner; his brother, Julian J. Meyer, who later withdrew from the firm; and Alice Schwartz, Sidney Schwartz's wife. Soon after, Emil Sutro, Albert Sprott and R.C. Walker also retired. Helen and Samuel Schwartz's son, Gustav Sutro Schwartz, became ill and went to Tahiti to try to recover his health, but he passed away in 1935 at the age of 36.

In the post-war period, as the older generation of Sutro family partners continued to pass on, the firm added partners in part through the acquisition of other firms and expanded by developing new departments in the firm. In 1942, Sutro & Co. bought the San Jose firm of Buchanan & Co., and Herbert Buchanan, Carl Ellithrope and Ellithrope's son-in-law, Harvey White, joined the firm. In 1949, Robert Harter, a vice president of First Boston Corporation, became a partner of the firm in order to direct the underwriting department, which began to grow steadily in importance in the firm. In 1953, the firm opened a mutual fund department under the direction of John Hoyt. Four years later, the firm merged with the San Francisco firm of Edwin D. Berl & Sons, and Edwin Berl, Warren Berl and John D. Berl joined as general partners. Throughout these changes, Sidney Schwartz remained the senior partner.

In 1959, when Schwartz became a limited partner and stepped down from active management, he was succeeded by Alaistair Cameron Hall, the first senior partner who was not related to the founders. Born in Scotland, Hall was educated in Edinburgh. Also known as "Shorty," Hall had been the senior partner of A.C. Hall & Co., a firm based in the Philippines. Hall had moved to the Philippines from Scotland in 1924. He formed his firm in 1933 and also served as the president of the Manila Stock Exchange.

During World War II, Hall was a prisoner in the Santo Tomas prison camp. After the war, he returned to business and in 1951 founded Hall, Picornell, Ortigas & Co. in Manila, which became a Sutro & Co. correspondent. (Sutro & Co. had conducted business in the Philippines since 1912 when it participated in a syndicate that bought an estate on the Island of Luzon, where it built a sugar mill. The firm also had a correspondence office in Hawaii in 1892.) In 1953, Hall decided to leave the Philippines and settled in San Francisco. In 1954, Hall left retirement and became a Sutro & Co. partner. He naturalized as an American citizen the following year.

Sutro & Co., Inc. (1970)

In 1970, when Sutro & Co. announced that it was incorporating, Hall became chairman of the board. Stating that the decision "was a question of growth and efficiency," the firm announced, "The growth pattern

of Sutro & Co. indicated that we needed the flexibility of the corporate structure." Sidney Schwartz became a special adviser to the firm. Warren Berl was named president and treasurer. When Hall died in 1971, Berl became chief executive officer, a position he held until 1983.

The son of Edwin David Berl, Warren Harry Berl was a San Francisco native and a 1942 graduate of Stanford University. After serving in the US Navy during World War II, he joined his father's firm, Edwin D. Berl & Sons (originally called H. Berl & Son, founded in San Francisco, 1882). In 1957, Sutro & Co. merged with Edwin D. Berl & Sons, and Warren Berl joined Sutro & Co. Early in Berl's tenure, regional brokerages seemed to be surviving the bear market, as well as competition from national firms. But after the NYSE changed its competitive rate structure in 1975, Sutro & Co. felt the need "to diversity its product line so less of its business [was] dependent on commissions," and it expanded into municipal and corporate bonds, tax shelters, insurance and estate planning. By 1977, the firm had 440 employees and about $8 million in capital. Warren Berl's family also started a legacy of its own within the Sutro firm. His brother, John D. Berl, joined Sutro & Co. and became a senior vice president of the Los Angeles office. His son, Douglas A. Berl, joined the San Francisco office.

In 1983, Berl became chairman of the executive committee and was succeeded by Ross L. Cobb. A native of Vermont, Cobb joined the firm in 1959 as a mail clerk. The son of a carpenter, Cobb was a graduate of the University of Vermont. He moved to San Francisco after serving in the Air Force during the Korean War. Cobb, who had been director of operations since 1968, had been president and chief operating officer since 1972. He became chairman of the board and chief executive officer in 1983.

John Hancock Mutual Life Insurance Company (1986)

By the time Cobb became chief executive officer, deregulation added another layer of challenges for the firm. Starting in December 1982, deregulation of interest rates for banks and savings institutions led to a drain on capital from money market mutual funds into new banking money-market accounts from $195 billion to $37 billion. According to *The Palm Beach Post*, "The banks offered higher interest rates than the money-market funds and, unlike the money funds, the banks' deposits are insured by the federal government." The *Post* reported that "Funds that [operated] primarily in areas where banks were especially aggressive have been hit the hardest," including Sutro's Money Market Fund which declined from $208.4 million to $129.1 million. Warren Berl was quoted as saying, "There's no doubt about it, the banks hurt us."

In 1986, Sutro & Co. was bought by the John Hancock Mutual Life Insurance Company. Based in Boston, John Hancock was "one of the nation's largest and oldest insurance companies," and like many firms around this time, began to diversify into financial services. John Hancock was a big advocate of deregulation, which also paved the way for these cross-industry acquisitions. In the early 1970s, the NYSE changed its rules allowing member firms to sell insurance products, and in the 1980s, "the Federal Reserve loosened the restrictions that prevented the merging of insurance companies and banks with investment firms." After the sale, Cobb retired from the firm.

Sutro & Co. remained a part of John Hancock until 1996, when John Hancock decided to end its effort to diversify and concentrate on its insurance business. It sold Sutro & Co. along with Tucker Anthony, Inc., another brokerage house it bought in 1982, to "an investor group led by corporate buyout specialist Thomas H. Lee for about $180 million." The new holding company that merged the firms was called Freedom Securities.

At the time, Sutro & Co. had "about 620 employees in 21 offices, most of which are in California and the West," while Tucker Anthony had "1,300 employees in 39 offices located largely in the Eastern United States." The logic behind the merger was "to capitalize on each organization's name recognition, historical areas of expertise and close community ties while lessening the [firm's] reliance on a single region's economy," and drawing on "the experience and tenure of its investment executives, which [had] often led to long-term relationships with clients in their respective communities," among other cultural characteristics like a focus on personalized service.

Freedom Securities Corporation (1996) Tucker Anthony Sutro Corporation (2000)

Sutro & Co. and Tucker Anthony Inc. went public in 1998—two years after the firm was sold. Then in 2000, Freedom Securities, the parent company, changed its name to Tucker Anthony Sutro. The following year, Tucker Anthony Sutro was sold to the Royal Bank of Canada (RBC), founded in 1901, which was then "Canada's largest commercial bank." It was combined with Dain Rauscher, a Minneapolis securities firm RBC bought in 2000. RBC's purchase of Tucker Anthony Sutro was part of its plan to expand in the American market. By merging its subsidiaries, RBC created "the ninth largest full-service securities firm in the United States."

The new firm was called RBC Dain Rauscher. With that change, both the Tucker Anthony and Sutro names were lost. According to Irving Weiser, the chairman, president and chief executive officer of Dain Rauscher, "The move to the RBC name is part of a strategy to create a national firm… Brand recognition across the country is the No. 1 benefit." Others disagreed. Regarding the name change, Richard Skaggs, the son of the founder of the San Francisco firm Davis Skaags & Co. said, "They should try to save the name Sutro… The silly bastards. The whole state of California knows the name." $

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About This Series The "Where Are They Now?" Series traces the origins and histories of 207 of the underwriters of the 1956 Ford Motor Company IPO. The research for this series has been generously funded by Charles Royce of The Royce Funds.

With Glowing Lamps We See Thee Rise

The Global Oil Industry Started in Canada in 1858


Fairbank Oil

By Gregory DL Morris

Venerated or vilified, the worldwide oil business is arguably the largest industry on the planet, and has had the most profound effect on human society and the environment. It all started 160 years ago. In Canada.

The first documented commercial oil well in North America, and for all intents and purposes in the world, was dug in August 1858 by James Miller Williams in Oil Springs, Ontario, southeast of Sarnia. The more widely known, and heavily promoted oil well by Edwin Drake near Titusville, Pennsylvania, was drilled almost exactly a year later, in August 1859.

Boosters of the Drake well once dismissed the Williams well as a hand-dug affair little different from the techniques First Nations had been using for centuries to gather oil and tar to use as medicines, adhesives and coatings. That was true of the log crib that Williams used to support the sides of the excavation. But the cable tools used to dig, and the rest of the operation to collect, process and distribute the oil were the epitome of Victorian industrialism.

More to the point, the regional industry that grew from that first well was a fully-integrated commercial enterprise. Most of the small companies were vertically integrated from crude production and gathering to processing and distribution. Some specialized in one aspect or another. Many sold shares, while others were privately held. Markets were sought not just in Canada and the United States, but in Europe as well.

In short, the Williams well broke ground for a full-fledged industry that was commercial, and profitable, from the start. Fairbank Oil Properties started with a well on land acquired from Williams. The company still exits and is the oldest continuously operating oil business in the world. To this day, there are refineries and chemical plants in Sarnia, the nearest big town to Oil Springs. The same was true of Drake in Pennsylvania. Williams was just first.

The first to be commercially successful on an industrial scale, that is. Through the first half of the 1800's there were many efforts in the United States, Canada and

Fairbank Oil Property in Oil Springs, Ontario, Canada. The company still exists and is the world's oldest continuously operating oil business.

Europe to make a business of oil. All were small scale cottage-industry operations. There were separate, and initially more successful efforts to commercialize natural gas.

The earliest commercial use of natural gas took place in 1825 in Fredonia, New York, halfway between Buffalo and Erie, Pennsylvania. According to the American Oil & Gas Historical Society, gas was piped to several stores, shops and a mill from a downtown gas well drilled by William Hart, who some consider to be the father of the gas industry. Records at the New York State Energy Research & Development Authority show that shallow gas wells were soon drilled throughout the Chautauqua County "shale belt."

The gas was piped to businesses and street lights in Fredonia at the cost of $1.50 a year for each light, approximately $22 today. The gas streetlights became an attraction for travelers—there was no such thing as tourists in those days. There were also more significant aids to navigation. The first Lake Erie lighthouse illuminated by gas was built in 1828 at Barcelona, New York. That original Hart well continued to flow until 1858, the year Williams dug his oil well just 200 miles away.

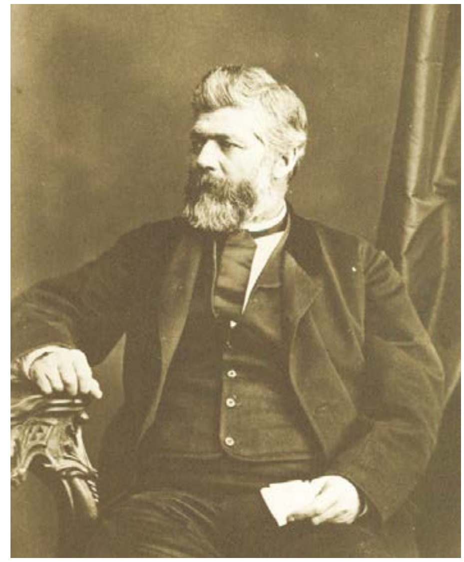
One of the most active, and mercurial, figures in the early oil business in North America was Charles Tripp. Originally from Schenectady, New York, Tripp was a visionary. As early as 1852 he applied for a charter for the International Mining & Manufacturing Company to produce commercial hydrocarbons from the seeps and gum beds around Oil Springs, Ontario, according to the Oil Museum of Canada in Lambton County, Ontario. The charter was granted by colonial authorities in 1854; Canada did not gain autonomy from the United Kingdom until 1867.

"Charles Tripp went to the Cooper Carriage Factory to buy wagons to haul the oil," said Christina Sydorko, education and program coordinator at the Oil Museum. The owner of the wagon firm was James Miller Williams, who knew the next big thing when he saw it. The carriage business was thriving, but the railroad was coming, and Williams was already alert to new opportunities.

The groundwork for that opportunity had been done not by the early natural-gas businesses, but by entrepreneurs in coal oil and derivatives for lighting. "The coal-oil refiners in the 1850s did everything to create the oil industry except find crude,"

Oil Museum of Canada

Charles Tripp was one of the most active figures in the early North American oil business.



Oil Museum of Canada

James Miller Williams is commonly viewed as the father of the petroleum industry in Canada.

wrote Earle Gray in *Ontario's Petroleum Legacy: The Birth, Evolution and Challenge of a Global Industry* (Heritage Community Foundation, 2008). Gray was editor of *Oilweek* magazine, and before that was the director of public affairs for Canadian Arctic Gas. He has written eight books about Canada's energy industries.

According to Gray, the coal-oil pioneers "created a lamp fuel; developed and improved the technology to produce it from bituminous materials; built [small] refineries; gave rise to improved oil lamps; and created the marketing facilities and market demand. All that was then needed was a supply of crude oil, which could greatly cut the cost of making lamp fuel from solid coal or bitumen. That was the missing link first supplied by James Miller Williams."

Tripp had been so close. "He had focused on asphalt," said Sydorko. "He did produce naphtha and kerosene by distillation. Tripp loved his oil fields, but he was going to lose them: the carriage company sued Tripp for monies owed, and by way of settlement Williams got the land. But Williams was not rapacious. He was kind to the Tripp family. They stayed in the picture."

With plans to dig several oil wells around the gum beds to determine how deep they were, Williams first dug a water well to supply the works. The first was sunk to a depth of about 14 feet and cribbed, lined with logs to keep the walls from slumping.

"The next morning the well had filled with sour [sulfurous] crude and salt water," said Sydorko. "The well was eventually deepened to bedrock at about 40 feel. An article in the *Sarnia & Lambton Observer-Advertiser* states that the well produced five to 100 barrels of oil a day."

Those were wooden whiskey barrels from the Hiram Walker distillery, not the standard 42-gallon barrel used worldwide today.

Originally Williams owned the fields with his partners in Hamilton, Ontario, but he bought them out, Sydorko added. "He formed the J.M. Williams Company and was successful. He was making money. Colonel Drake was well aware of what Williams was doing. Williams had a refinery on site, and then in Hamilton, an industrial port city from which he sold worldwide. We have an advertisement from the *Hamilton Daily Spectator* advertising machinery and illuminating oils." (See page 33.)

In 1861, John Henry Fairbank bought a small parcel of land from Williams and established his own company. He was a surveyor working in the area who was asked to delineate some oil properties and caught the bug. The next year he dug a successful well. Fairbank was another ex-pat American; he was originally from Rouses Point, New York.

Fairbank is credited with inventing the jerker-line system, an array of wooden rods connected by metal links, all suspended so it could slide back and forth. The arrangement allows a single steam engine to pump dozens of wells simultaneously. More rustic Rube Goldberg than steampunk, it worked so well that it was adopted in the early oilfields of Pennsylvania and then around the world.

A Primer on the Shale Bonanza

For more than a century, from the Williams well through the 1980s, energy companies drilled vertically into pockets of oil and gas called reservoirs, or stratigraphic traps. Those had accumulated over millions of years in voids and porous formations like sandstone as the hydrocarbons flowed molecule by molecule from their kerogenic source rock. Those shales are the remains of ancient swamps, where eons of organic matter were transformed by heat and pressure.

It had never been economically feasible to drill source rock. The strata could be as thin as a few dozen feet top to bottom. Also the rock was too dense, the pores too small to allow economic flow.

Three separate developments were brought together by a company called Mitchell Energy in the 1980s: three-dimensional seismic surveys to assess source rock, direction drilling that allowed the bore to be turned sideways through the shale layers and hydraulic stimulation where sand and water were used to open micro-channels in the source rock allowing economic flow. That is also known as hydraulic fracturing, or fracking. Together the technologies are known as unconventional development, or resource development, in contrast to conventional or reservoir development.

Fracking has become highly controversial. It has been wildly successful, and now the United States is among the top oil and gas producing nations. There have also been spills and leaks, as well as industrialization of previously rural farmland.

There have also been many myths and misreprentations. Most wells go about two miles deep and then two miles laterally. For the record, it is not physically or geologically possible for fractures from the well to propagate anywhere near the surface or even to aquifers. Most fractures run about 500 feet from the borehole. That said, there have been surface spills of chemicals and hydrocarbons, as well as casing leaks.

In the boom days of the shale bonanza, state and local regulatory oversight was poor, as was the industry's willingness to police its less-than-diligent members. Those realities are now changing, but the controversy remains.

Gregory DL Morris

Sign marking the site of the first commercial oil well in North America.

John Henry Fairbank expanded into the grocery business, the same sector where young John D. Rockefeller got his start in Cleveland. At the time, most kerosene and other petroleum derivatives were sold in tins and drums at hardware and grocery stores. He and Miller operated a refinery, and Fairbank also dabbled in banking.

Parts of Fairbank's operations were acquired by another company that ultimately became part of the Standard Oil colossus. But Fairbank Oil Properties is a going concern today, according to Sydorko. It is still family held, with the third generation now running the show. It is the oldest documented continuously operating oil company in the world. Current production has been estimated at 24,000 barrels a year. Standard barrels, not whiskey barrels.

The man who took Canadian oil expertise to the world was William H. McGarvey. According to the Canadian Petroleum Hall of Fame, "McGarvey was from Huntingdon, Quebec. He moved to the booming Ontario oil region of Oil Springs and Petrolia in 1860 and formed his own mercantile and oil business. In 1874, McGarvey and other oilmen took a commission from the Geological Survey of Canada and explored the Swan River Valley near Fort Pelly in eastern Saskatchewan.

"Exploration opportunities further afield took him away in 1879 when he moved to Oelheim, Germany to look for oil. McGarvey hired drillers from Ontario and drilled the first big well near Krakow [now in Poland]. He also built the first refinery in the area. In 1882, McGarvey moved his family to Austria, and, upon the marriage of his daughter to Count Von Zeppelin in 1895, he gave the couple a 700 acre estate and castle.

"The expanding oil company, Galzische Karpathen-Petroleum Aktien Gesselschaft, eventually made McGarvey one of the world's leading petroleum technologists with more than 2,000 men working in his operations. Russians set fire to his wells and blew up his refineries in 1914, and on his birthday that year William McGarvey, Canadian foreign driller, suffered a stroke and died."

As indicated by the invention of the jerker-line system, all of the oil production in the early days was from wells, really pits, dug with cable tools. Those were heavy chisels suspended by long wires from flexible poles that were braced at the other end. The rig resembled a fishing rod and line with a heavy chisel rather than a hook. The pole was flexed, dropping the weight onto the rock and pulling it back up again. Oil flowed or seeped into the hole and was pumped out.

The pole-drilling technique persisted even after Drake established the value of a rotary bit on a metal shaft, usually driven by a chain attached to a steam engine. Drake also pioneered the use of large-diameter pipe to line the bore, now called casing. The sticky clay and gum beds of the

Oil Museum of Canada

Spring pole drilling rig, Bothwell, Ontario, 1860.

Towards the close a fight occurred in which one of the employees of the Hotel was badly beaten by rowdies.

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In quantities of from 1,000 to 4,000 galls., 25 cents per gall. From 4,000 to 100,000 galls., 16 cents per gall.

J. M. WILLIAMS & CO.

Hamilton, July 4th, 1860. 348

Mechanics' Institute.

Oil Museum of Canada

Advertisement for J.M. Williams & Co.'s Refinery, published in the *Daily Spectator and Journal of Commerce,* July 4, 1860.

Oil Springs area, saturated with tar and water, tended to clog and stall rotary drills.

The first gusher was hit in 1862 at 270 feet. Who struck it is less clear. For decades historians thought it was a man named Hugh Nixon Shaw, but recent scholarship suggests that it was actually John Shaw, according to an analysis by the Lambton Country Archives.

The analysis states, "Newspaper articles from the *Toronto Globe* and the *Hamilton Times* in 1861 and 1862 refer to 'Hugh Shaw' as a successful businessman who patented a still and opened a refinery in Oil Springs. He died in a tragic accident on February 11, 1863, 'of suffocation, caused by inhaling poisonous gases from a well at Oil Springs…'

"Primary sources do not support Hugh as the oil gusher pioneer," the archives report continues. "There are no references to Hugh and the oil gusher in any 1860's newspapers. The first reference to Hugh and the gusher appears two decades later in *Belden's Illustrated Historical Atlas of Lambton, Ontario*, 1880. Also telling is the fact that Hugh's own journal of business expenditures from 1861 to 1863 does not refer to the gusher."

The archive analysis concludes, "John Shaw was a significantly less successful businessman. *The Toronto Globe* described on February 2, 1862 how '… last January found him a ruined, hopeless man, leered at by his neighbors, his pockets empty, his clothes in tatters…' John got lucky with his gusher, and his accomplishment is referenced numerous times in 1860's newspapers including the *Hamilton Times, Toronto Leader, Toronto Globe, New York Times* and *Sarnia Observer* (eight separate articles). *Hamilton Times* proclaimed on January 20, 1862, 'Mr. John Shaw, from Kingston, C.W., tapped a vein of oil in his well…the present enormous flow of oil cannot be estimated at less than two thousand barrels per day of pure oil…'"

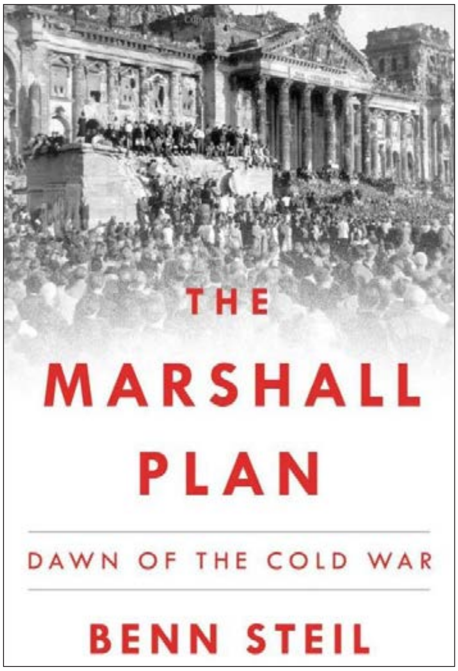
By 1866 the center of oil production in the region shifted to Petrolia, Ontario. By the turn of the century oil was a global business. Imperial Oil was founded in Canada in 1906 in an effort to achieve the economies of scale that drive all commodity industries, and to fend off the American Standard Oil. It didn't work. Standard bought a controlling interest in Imperial in the 1930s.

But innovation did not end in the region. The refineries and chemical plants made important advances in fuel and elastomer chemistry as part of the war effort in the 1940s. Pioneering work in synthetic rubber sprang from the same ground as spring poles and jerker rods. Another technology invented there is for making polyethylene, the material of plastic bags and milk jugs. It is called Sclair, named for the St. Clair River that flows past Sarnia.

In the wake of the Bhopal disaster in India in 1984 that killed an estimated 15,000 people, the Canadian Chemical Producers Association developed mandatory codes of management practice for health, safety and environmental protection called Responsible Care. Plants in the Sarnia area were at the forefront of that development. The codes were adopted by industry associations in the United States and worldwide, and compliance is now certified by third-party audit.

Oil production in the area is now dwarfed by a single well in Alberta or Pennsylvania, but it continues. And just a few minutes' drive from the gleaming process towers around Sarnia stand the weathered wooden remains of those first Williams and Fairbank wells. They launched a global industry that changed the world and now produces close to 100 million barrels a day. Loved or loathed, it started here. The preservation and presentation are not as aggrandizing as are the sites in the United States, but then, this is Canada. $

Gregory DL Morris is an independent business journalist, principal of Enterprise & Industry Historic Research (www.enterpriseandindustry.com) and an active member of the Museum's editorial board.



The Marshall Plan: Dawn of the Cold War

By Benn Steil
Simon & Schuster, 2018
(A Council on Foreign Relations Book)
608pp with photos, cast of characters, appendices, notes and index

There is a picture of my father and his brother in uniform, meeting in Frankfurt sometime in 1945 or 1946. They are two American GIs, smiling and looking pretty well fed. The background of the photo tells a darker story. The building behind them is only half standing, and there is a pile of stones and twisted wood just next to them. The war in Europe left millions dead or homeless, cities flattened, roads and bridges destroyed. Beyond the obvious physical wreckage, even more fundamental damage had been done.

Institutions central to pre-war European societies—free markets, business organizations, individual ownership, capitalism—lay in ruins. In fact, many Europeans believed that these concepts had been among the root causes of the war. Were these worth re-establishing? And, if so, how could countries that were hungry, cold and financially weak do so when the most likely source of help (the United States) was shrinking its budgets, packing up and going home. For some Europeans, the Soviet model—seemingly more worker-friendly and less fraught with competition—looked attractive.

This is the background on which Benn Steil begins the story of the Economic Cooperation Act of 1948, better known as the Marshall Plan. In his book, *The Marshall Plan: Dawn of the Cold War*, Steil details how (paced by some extraordinary leadership), the war-weary, isolationist-tending United States got wise, found the money and spent it smartly to help Western Europeans get their mojo back. One result: 70+ years of progress and relative peace on a continent that had had centuries of war.

Steil, of the Council on Foreign Relations, has made a specialty of post-WWII financial and trade history. In 2013, I enthusiastically reviewed his book on the Bretton Woods conference, and I commend him again for a painstakingly researched and well-written book. Those interested in how successful international economic policies are constructed and applied by thoughtful adults should stop and read this book.

Steil starts off on the ground in a grim post-war Europe. Josef Stalin thought he had the whip hand in terms of influence. With FDR dead and Churchill tossed out of office, he was the last of the "Big Three." Soviet-leaning governments were in power in Eastern Europe, Soviet forces occupied half of Germany and Communist parties in Italy and France were set to gain political power among workers disillusioned with capitalism. Britain, which had traditionally checked Russia, could no longer afford to do so. This created uncertainty, which Stalin was happy to exploit to test how much he could extend Russian interests.

In the United States, leaders didn't really understand how the Russians operated or what long term effect the power vacuum could have on US interests. George Kennan, a senior State Department official and Soviet expert, stepped in and re-calibrated American thinking on Soviet intentions. Russia, Kennan wrote, would push its agenda as far as allowed, testing the West at shifting points around the globe. Europe was front and center of this effort, and the United States must conduct a policy of "containment" by shoring up European institutions, most importantly their economies. This concept was expanded on by George Marshall in a speech at Harvard in 1947, which forever linked the General to the plan for European reconstruction.

Those interested in how successful international economic policies are constructed and applied by thoughtful adults should stop and read this book.

Steil's focus then shifts to the political ground game through which US leaders convinced the American people and Congress that America—having paid for the war—should now fund the peace. He gives excellent insights on personalities from Marshall to Will Clayton to Dean Acheson, and a host of others as they cajoled and compromised their way to getting the funding legislation passed. One stand-out is Senator Arthur Vandenberg, a Michigan Republican and Senate Foreign Relations Committee chairman. Vandenberg's high ideals and bi-partisan canniness helped to turn back the isolationist instincts in Congress. That would be unheard of today.

Luckily, Marshall Plan proponents had help from an unlikely source: Russia. The USSR consistently misapprehended and misjudged US intentions and willingness to confront. Stalin did not want a resurgent Europe. He spurned the offer to include Russia as a recipient of aid, and he forbade vassal states like Czechoslovakia and Poland from participating. Germany,

of course, was the critical battleground between the two sides. Steil goes deep into the thrust and parry between the USSR and United States in the vanquished and divided former Reich. General Lucius Clay—the tough talking Military Governor of occupied West Germany—gets his due, as do others who orchestrated the famed Berlin Airlift.

Although more modest and less open ended, the final legislation was signed in 1948, and Marshall aid flowed until 1952. This was accompanied by more "energetic" efforts to sway Europeans towards the United States, by influencing public opinion and complementing economic assistance with military support through NATO.

Maybe it's my inner nerd, but I wish Mr. Steil had gone more into detail on how Marshall Plan assistance was actually delivered. We didn't just hand the participating countries money or food or machinery. There is some discussion of the "counterpart funds" mechanism, but I wanted more on how capital formation was reconstituted locally. I'll grant Steil this small omission, since he answers every geeks wish with a cast of characters and nutshell biography of anyone who had anything to do with the story. Somehow, even Al Gore makes the cut.

Over the years, the Marshall Plan has taken on talismanic qualities. If there is a problem, let's do a Marshall Plan. The author recognizes this and asks: did it really work? On pure economic or financial measurements, it's not crystal clear that the Marshall Plan alone galvanized European economies. But the Plan had more complex ambitions, which combined America's bent toward a peaceful Europe, a desire for healthy markets and a fundamental impulse against aggressive Russian Communism. On that level, the Plan was a resounding success. Steil's book is, too. $

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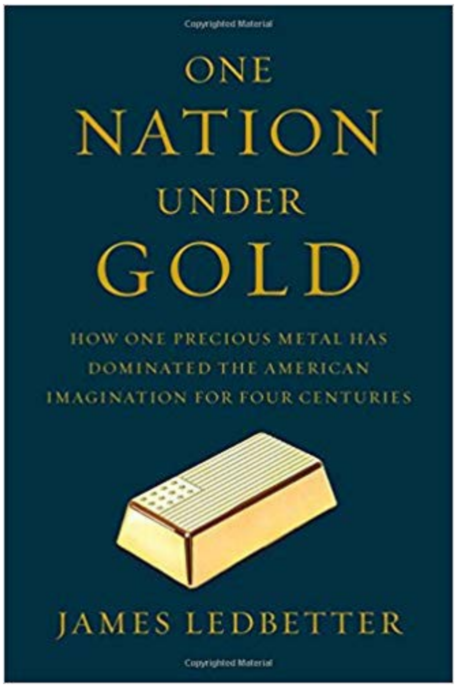

"One Nation Under Gold"
By James Ledbetter
Norton-Liveright Publishing, 2017
369 pages with notes

America's fascination with gold is a long and complicated tale, and James Ledbetter's *One Nation Under Gold* is a good way to begin to understand it. Gold's luster and beauty have mesmerized Americans—and their government as well; gold was an organizing force through much of the nation's financial history. To illustrate this, Ledbetter connects the booms and busts in the American economy to the gold markets.

Ledbetter asserts that the Founding Fathers disliked and distrusted paper money. Gold was always preferred—Ledbetter quotes a 19th-century government official attributing this preference to God's will—but dependence on gold for commercial transactions had consequences. The California gold rush that began in 1848 filled the nation's bank vaults with gold, and as it did the banks lent freely against it. Ledbetter quantifies the boom: $155 million worth of gold was mined in 1853, up 10-fold from the amount mined in the 1830s. Things came to a smashing stop in late summer 1857 for various reasons, including the wreck of the *USS Central America* in a hurricane off the Georgia coast that September, which took thousands of pounds of California gold (and 400 passengers) bound for New York to the bottom of the Atlantic Ocean.

The United States abandoned gold during the Civil War in issuing unsecured paper "greenbacks"—but only as a war expedient. Ledbetter describes gold's move to the center of American political debate during the last three decades of the 19th century. Eastern banking interests favored gold-backed money, while western agricultural interests favored the minting of dollars with more plentiful silver supplies to help buoy farm prices. Banking interests generally prevailed.

The economic slump that began in 1893 sharpened the oratory of these western "populist" politicians. Ledbetter spotlights Nebraskan William Jennings Bryan, who rose to speak at the Democratic National Convention in Chicago in July 1896 against this gold-backed money, or "gold standard" system, just as prospectors were about to strike gold in the Yukon. He told the conventioneers, "We shall answer their demands for a gold standard by saying to them, you shall not press down upon the brow of labor this crown of thorns. You shall not crucify mankind upon a cross of gold!" It was artful and biblical, but it was too late: a stampede to the Yukon would soon cause another surge in the nation's monetary gold stores. The political push for broader-based money subsided.

Political ironies abound in Ledbetter's tale. Opposition to Franklin Roosevelt's New Deal efforts to abandon the gold standard and increase dollar-denominated prices was often most strident in the farming/ranching parts of the country where such price increases were most needed.

Unmentioned in Ledbetter's US-focused account are the practical origins of gold's monetary role. Beautiful and rare it is, but gold's density—19.3 grams/cubic centimeter, almost twice that of lead—make it difficult to counterfeit and easy to store, features that appealed to medieval bankers. Gold's ability to retain value also goes largely undiscussed. FDR's 1934 re-valuing of the dollar to $35/oz. of gold and discontinuing dollar convertibility into gold (for Americans) Ledbetter characterizes as a welcome break with economic orthodoxy, but the dollar's decline in value since is not detailed.

Ledbetter describes the US government's difficulties in the 1960s with Bretton Woods arrangements, but not the underlying problem of dollar decline. The change in the Consumer Price Index (CPI) since 1934 has been about 1,900%—an average of 3.6% per year. If it tracked the index, gold would trade today for $670/oz. The current price is roughly $1,200. Gold's uncanny ability to retain value over long stretches is worth mentioning.

Gradual, decades-long trends make for poor television, and Ledbetter discusses the gold pitchmen of our era: the Alderdice brothers, Glenn Beck, Goldline International spokespersons—people who have touted not gold's ability to retain value but its "get rich quick" potential and survivalist cachet. Their ads have been successful (in the case of the Alderdice brothers, right up until they were arrested) because, as Ledbetter persuasively asserts, gold captures the imagination of an authority-questioning, freedom-loving people. $

Daniel C. Munson works as a chemical engineer and enjoys reading and writing financial and scientific history. His columns have appeared in Barron's *and other publications. He is the author of* Malice Toward None: Abraham Lincoln, the Civil War, the Homestead Act, and the Massacre—and Inspiring Survival—of the Kochendorfers *(2014).*